Resolution Foundation

BRIEFING

The trillion-pound question

Spring Budget 2020 and the tension between higher spending, low taxes and fiscal credibility

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Summary

Rishi Sunak will have been Chancellor for less than four weeks when he delivers not only his first Budget, but the first of Boris Johnson's premiership. In some ways, the lack of time to prepare will make little difference. It is already clear that this double first will include downgraded forecasts for economic growth from the Office for Budget Responsibility (OBR). And it is clear that the Budget's most eye-catching announcement (in pounds and pence terms) will be more detail on the manifesto promise of up to a £100 billion increase in capital spending over the next five years.

But elsewhere, time constraints on decision-making will matter for the very new Chancellor, because 2020 is the year in which the big economic decisions that will shape the whole parliament must be taken. The big choice concerns the balance that will be struck between day-to-day (current) spending, taxation and additional borrowing. Some welcome breathing space for the Chancellor is provided by the reality that this choice will be made across not just this Budget, but also the Spending Review and Autumn Budget later this year. Next month's Budget will therefore be the crucial start of a process, with the three fiscal events of 2020 in the round setting the economic course that will carry the government through to the next General Election.

The backdrop to these parliament-defining decisions is a deterioration in the UK's economic outlook. The Bank of England recently revised down GDP growth for 2020 by 0.7 percentage points, in line with an average downward revision across independent forecasters of 0.5 percentage points.

The OBR will likely follow suit when its forecasts are published alongside the Budget, with a downgrade to the size of the economy at the end of 2022 of around 0.5 per cent appearing likely. There are large changes in forecasts between any fiscal event, so this relatively small degree of change would hardly be surprising given that the OBR last published forecasts a year ago (the longest gap between official forecasts for more than 20 years). In that time, the UK has changed government and left the EU.

Moreover, our assessment of the complete effect of the changes to the UK economy since March 2019 suggests that revisions to the fiscal forecasts won't be as bad as many expect. We estimate that Robert Chote, in his final forecast as Chair of the OBR, may actually have a small parting gift for the Chancellor in the form of improved expectations for the public finances.

This is largely the product of lower interest rates and lower inflation reducing the cost of government debt, and the fact that weaker-than-expected GDP growth is being combined with a slightly stronger-than-expected labour market. So, far from a

deterioration, changes to the economy – when viewed in the round – imply that the OBR may provide a small improvement to the public finances of around £8 billion in 2022-23.

This small windfall is good news for the Chancellor, who otherwise would have had to contend with headroom against his predecessor's fiscal rule of a current balance in 2022-23 of only £3 billion (or just 0.1 per cent of GDP). Our projection implies that he may now have very slightly healthier – but by no means large – headroom of around £10 billion.

This welcome fiscal news will not remove the need for the Chancellor to make difficult choices, however, as it simply moves his fiscal headroom into line with past averages. His choice is therefore how to balance the different priorities of this government: spending increases, low taxes and fiscal credibility. Something (or a bit of each of these commitments) will have to give.

It seems unlikely that the government will simply maintain existing current spending plans, not least because it has already made pledges on the likes of schools funding that require extra funding to fulfil. In addition, both public attitudes and the state of public services point towards spending rising rather than falling further, which current spending plans imply would be the case for departments outside health. Public support for spending (and tax) increases has almost doubled since 2010, with 57 per cent of adults now in favour. This reflects mounting evidence on the deterioration in performance of key public services. For example, the proportion of accident and emergency attendees not admitted, transferred or discharged within four hours has soared from 5 per cent in 2011 to 24 per cent in 2019.

Departmental spending commitments in the 2019 Spending Round and large increases in capital investment set out in the Conservative manifesto demonstrate that the Conservative party position on public spending has shifted decisively away from the small-state focus of the 2010s. Rishi Sunak may have said in 2015 that in normal times "public spending should not exceed 37 per cent of GDP". But he has just become Chancellor in a government set to preside over a state that is over 40 per cent of GDP (based on 2019 Spending Round and manifesto commitments) and is on track to remain at least this large until 2023-24, which is the first year in history that annual state spending will pass the £1 trillion mark.

The big question of this parliament is, then, the extent to which the government's 'levelling up' agenda, and desire to signal clearly that the austerity years are in the past, push spending higher still. Our estimates suggest that such changes would not come cheap. Reversing half of the reduction in per-person, non-health departmental spending since 2010 would entail £24 billion of additional spending by the end of the parliament. The Prime Minister's pledge to fix the crisis in social care once and for all will not be easy to fulfil. And preventing child poverty from rising any further would entail £5 billion injected into welfare spending to head off the effect of previous cuts, some of which are still in the process of being rolled out.

With the scale of spending required to meet the government's levelling up and austerity-ending ambitions high, 2020 will be the year in which we find out how firm these ambitions really are, and the combination of higher taxes and a looser approach to fiscal rules that will be used to accommodate a bigger state.

On fiscal policy, the focus is currently on how the Chancellor may tweak his predecessor's rules. But in practice, small changes are likely to make little difference, and the real question is whether the Chancellor leaves himself (too) little headroom. Delaying the point at which the current balance rule applies even by two years (to 2024-25) would buy the Chancellor only slightly more fiscal space – around £5 billion. It should also make little difference to overall fiscal decision-taking given that greater headroom should be held against fiscal rules that stretch further into an uncertain future. Headroom of either £10 billion (against the existing 2022-23 one) or £15 billion (against a 2024-25 rule) would be significantly smaller than the average forecast revision three years out (£29 billion) or five years out (£53 billion). So in either scenario, running down headroom on the rule would be risky.

More major changes to the fiscal rules set out in the Conservative manifesto would be possible, but difficult to justify given they were only published three months ago. And it would be a big mark against the government's economic credibility if their first major economic decision was to abandon the cross-party consensus that day-to-day spending should in normal times be financed through taxation, not borrowing.

This points to the need for a big focus on how this government might raise additional tax revenue – and stop reducing revenue through tax cuts. At first glance, the Chancellor's hands are tied by the election commitment not to raise income tax, VAT or National Insurance. But in practice there are sensible approaches that this government could take to provide more fiscal flexibility.

Sensibly, the government has already moved away from promising big tax cuts. The Conservative manifesto cancelled the planned corporation tax cut from 19 per cent to 17 per cent which, even net of a range of smaller business tax cuts, provides around £5 billion of additional revenue by 2022-23 (already factored into our estimates of fiscal headroom, above). Welcome, too, was the lack of a firm manifesto commitment to raise the National Insurance Contribution (NIC) threshold to £12,500. Were that target to remain a priority for the Prime Minister, a sensible approach would be to increase the NICs threshold while freezing the income tax personal allowance at £12,500 to help align the two. Achieving the £12,500 ambition by the end of the parliament would carry a net cost of only £400 million if both the personal allowance and higher-rate threshold were frozen, but with the side effect of continuing the trend of bringing more taxpayers into the higher rate of tax.

There are, of course, other tax-cutting temptations. Fuel duty has been repeatedly frozen at successive budgets and is now 29 per cent lower than pre-2010 plans, costing the Treasury £11 billion per year. Continuing to freeze fuel duty would leave an additional £4 billion hole in the government finances by 2023-24 and also sit poorly with the government's climate agenda. A cautious approach of increasing fuel duty in line with CPI inflation, rather than the default RPI, would reduce this annual cost to £1 billion.

Beyond avoiding tax cuts, there are a range of sensible small changes the government could make in the short term to increase revenue and create a fairer tax system. These include:

- Scrapping the poorly designed Entrepreneurs' Relief to raise up to £3 billion a year for other priorities. Or – if the government is prepared to continue paying for an expensive signal for potential entrepreneurs – raise a still substantial proportion of that by reducing the cap on lifetime gains to £1 million and tightening eligibility to stem abuse;
- Freezing the generous tax thresholds for VAT and inheritance tax, raising around £150 million and £400 million, respectively, in 2023-24; and,
- Delivering on a promise to "prioritise the environment" in this Budget, including by reforming Vehicle Excise Duty to increase up-front taxes on the most polluting new cars.

In order to raise significant additional revenue, a longer-term strategy for more fundamental reforms should be set out. Pension tax relief has a net cost of £35 billion a year and could be better targeted, for example via a flat rate of tax relief (raising up to £9 billion if set at 20 per cent) or a reduction in the maximum tax-free lump sum (raising £2 billion if set to leave three quarters of lump sums unaffected). The new government also has the opportunity to reform or replace inheritance tax to raise revenue and reduce loopholes for the wealthiest. This should include looking again at £800 million of business and agricultural property reliefs, and at the generous treatment of inherited pension pots.

Finally, regional disparities in council taxes are hard to justify, and do not align with the government's 'levelling up' agenda, with a £130,000 Band C two-bed semi in Blackpool paying more in council tax (£1,624) than a £67.5 million nine-bed house in Mayfair (£1,508). Material reforms, not least updating property valuations from 1991, would be welcome.

Even replicating relatively minor Scottish changes (increased rates for higher bands) in England would raise over £1 billion a year.

With consultation on the detail of any such reforms being crucial, next month's Budget should be seen in the broader context of 2020 being the year the big economic decisions of this parliament will be taken. Beyond the nature of the Brexit deal, it is the three fiscal events taking place this year that will together determine the tax, spending and borrowing mix that will take us through to the 2024 election. The government's desire to spend more is easy enough when it comes to capital investment (in terms of the fiscal space to do so, if not practically). To boost day-to-day spending it could bend its fiscal rules, but tax rises provide a far more sustainable answer. So, the question for 2020 is whether the Conservatives, having given up being a small-state party, are also content to say goodbye to being a low-tax party.

The prospects for the UK economy have deteriorated since the OBR's previous forecast

The uncertain and changeable economic environment is the backdrop to what is set to be one of the most consequential Budgets of the past decade. The government has an ambitious policy agenda: to deliver visible improvements to public services and to 'level up' regions lagging behind the South and London, all while refusing to raise any of the main taxes. As ever, the government's room for manoeuvre will depend on the official OBR forecasts for the economy and public finances.

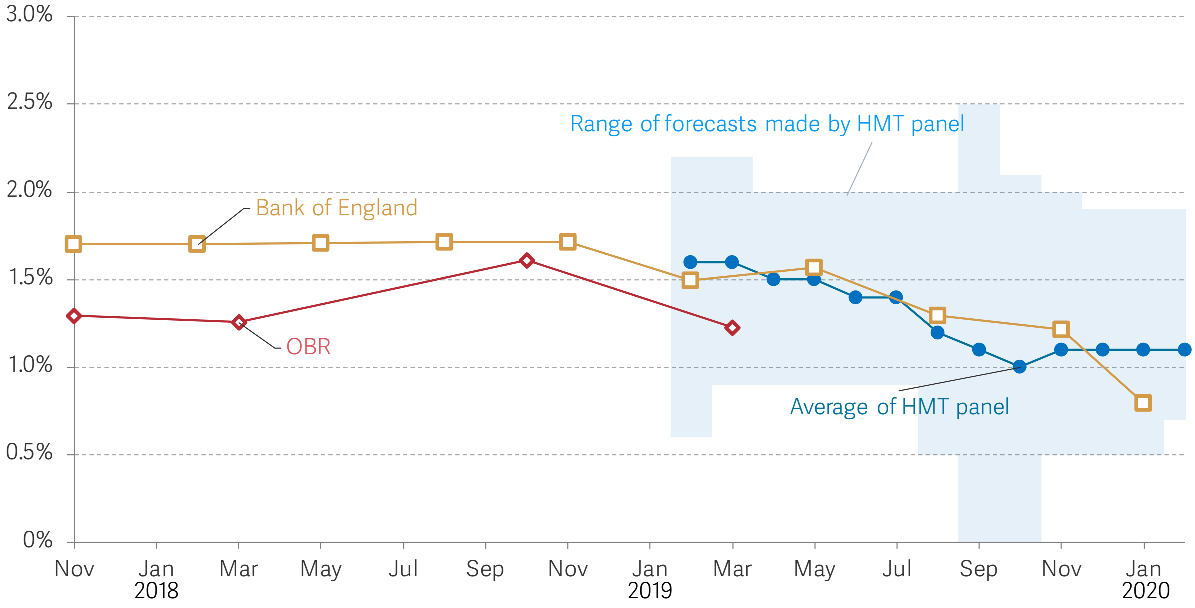
There is more scope than normal for dramatic changes in the economic forecast, with a consequential effect on the fiscal forecast. It has been almost a year since the previous official forecast – representing the longest gap between forecasts since the change of government between 1996 and 1997.[1] This potential for revision is further magnified by the substantial economic developments over the past year: Brexit uncertainty, weakness in major Eurozone economies and an off-and-on trade war between China and the US.

But what view is the OBR likely to take? As Figure 1 shows, economists expect the 2020 growth rate to be lower than they did a year earlier. The Bank of England has downgraded its forecast by 0.7 percentage points since March last year, with other forecasters downgrading by slightly less on average (0.5 percentage points).

1 Prior to 2010, forecasts were made within HM Treasury rather than by the OBR.

FIGURE 1: **Expectations for UK growth have been falling since last year's Spring Statement**

2020 calendar-year forecasts for real GDP growth, by date of forecast: UK



SOURCE: RF analysis of HM Treasury; Bank of England

The OBR was already towards the pessimistic end of forecasts in March 2019, so the growing weakness in investment and consumption in 2019 may have come as less of a surprise. But revisions to the OBR's expectations for the size of our economy are still likely to follow. Based on the range of shifting expectations for the growth rate this year, a downgrade to the size of the economy at the end of 2022 of around 0.5 per cent would seem a reasonable assumption.[2] This downgrade would be material but is not exceptionally large from a historical perspective: larger downgrades to the OBR's GDP forecast were made in December 2012, November 2016 and November 2017.

Despite a downgrade in economic fortunes, the OBR may provide more positive news on the fiscal forecast

The fiscal forecast is likely to be better than many expect because weaker GDP growth is not the only – or even the most important - thing affecting the fiscal outlook. In contrast to this weaker growth, other developments in the economy over the past year have moved in a positive direction for the government's finances, particularly interest rates, inflation and the labour market.

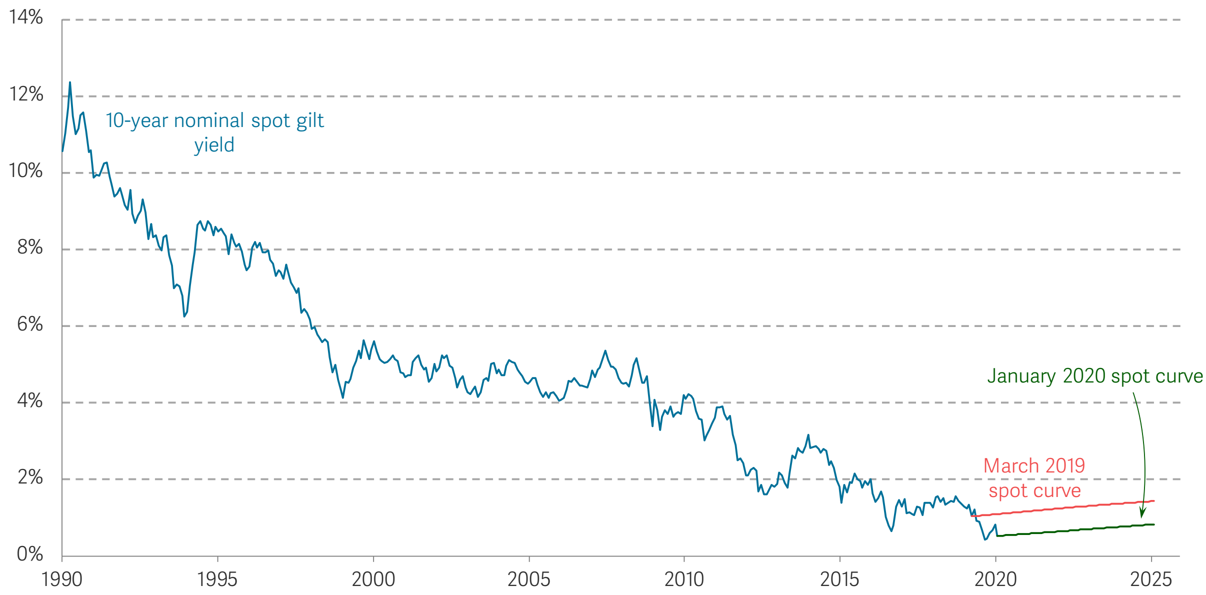
Globally, interest rates have been falling since the US Federal Reserve started to cut their main policy rate in mid-2019. This has reduced expectations for rate rises from the Bank

2 For details of how we have come to this judgement, see: J Smith & J Leslie, Macro Policy Outlook: 20201 Q1, Resolution Foundation, February 2020

of England, further compounded by the weakening in the UK economy. The result has been a decline in the 10-year gilt spot rate by around 50 basis points since March 2019 – as shown in Figure 2.

FIGURE 2: **The cost of government debt has fallen over the past year**

10-year nominal spot gilt yield and curve, March 2019 and January 2020: UK



SOURCE: RF analysis of Bank of England, Monthly government liability curve (nominal): archive data

Lower interest rates reduce the cost of government debt, both in terms of new borrowing and any debt being rolled over. In addition, around 20 per cent of government debt is financed with index-linked bonds,[3] and so interest costs also vary with inflation. The outturn for RPI inflation in 2019 was 2.6 per cent, slightly below the 2.9 per cent expected by the OBR in March. Prospects for inflation this year have fallen even further, partly as a result of changes to the energy price cap set by Ofgem. This lower inflation will further reduce government spending on debt interest.

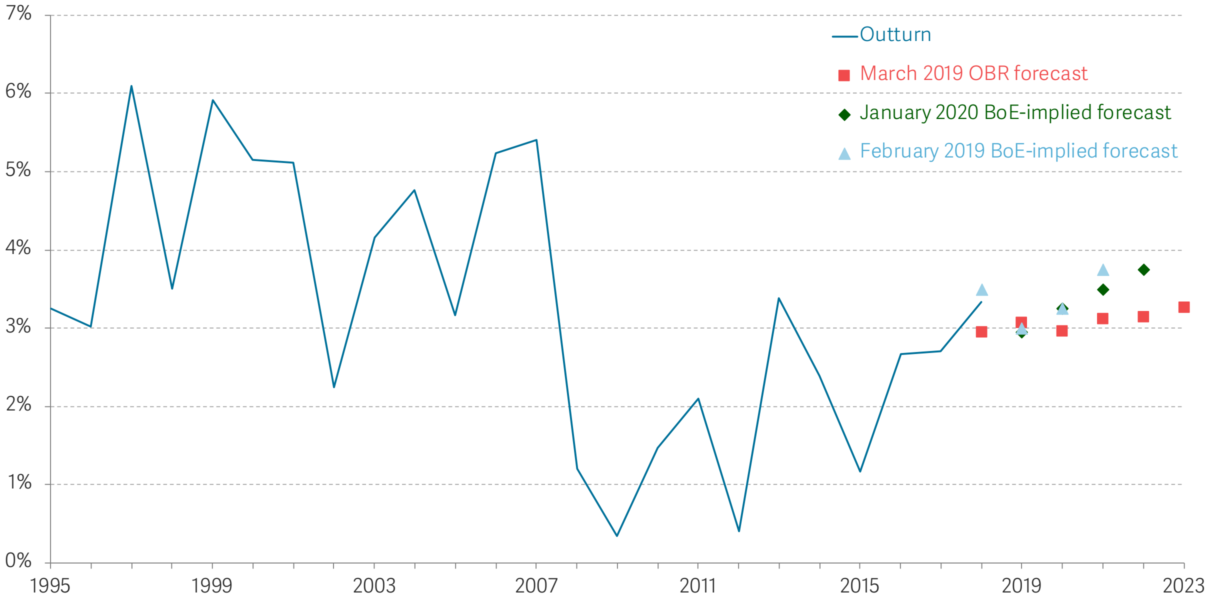
But borrowing costs are not the only factor driving a potential divergence between the OBR's GDP and fiscal revisions. In marked contrast to the deterioration of economic growth, the labour market has performed better than the OBR expected a year ago. The employment rate is at a record high of 76.5 per cent, while annual (nominal) growth in average weekly earnings remained above 3 per cent for all of 2019, the first year since the financial crisis in which this happened. A stronger labour market improves the government's fiscal position as higher wages and employment lead to more tax revenue

3 HM Treasury, Debt Management Report 2019-20, March 2019

coming in, and conversely lower the welfare bill. As Figure 3 shows, wage growth in 2018 was materially higher than the OBR had expected (the full data for 2018 was not available at the time of their March 2019 forecast).

FIGURE 3: **Wage growth could rise faster than the OBR expected a year ago**

Annual growth in nominal wages per employee, outturn and OBR and Bank of England forecasts: UK



NOTES: The definition of wage growth used by the Bank of England differs from the outturn series here (which is consistent with the OBR definition). The Bank of England forecast is based on Office for National Statistics data for Average Weekly Earnings, whereas the OBR uses a National Accounts definition of wages per employee.
SOURCE: RF analysis of ONS, various; Bank of England, February 2019 Inflation report and January 2020 Monetary Policy Report; OBR, Economic and Fiscal Outlook, March 2019

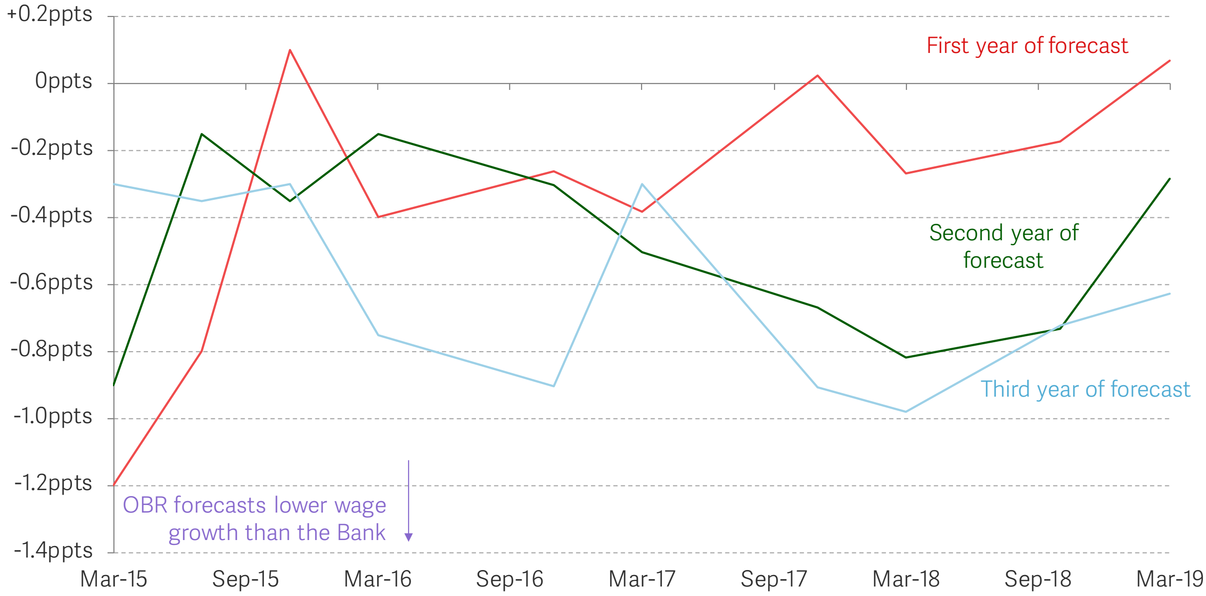
This upside news on wages might lead to the OBR taking a more optimistic view of wage growth over the coming years, perhaps in line with the latest Bank of England forecast, which has wage growth gradually rising to close to 4 per cent in 2022. However, while the latest Bank of England forecast (shown by the green diamonds in Figure 3) is higher than the OBR's expectations last year, the Bank has not become more optimistic relative to its *own* expectations a year ago (the light-blue triangles).

Moreover, a longer view tells us that the OBR coming in lower than the Bank of England on wage growth expectations is a common phenomenon. Figure 4 shows that, on average, the OBR has annual wage growth 0.3 percentage points lower than the Bank of England's estimate in the first year of the forecast, rising to a gap of 0.6 percentage points by the third year.[4] This means that the OBR's forecast may well be revised up in the short term but remain lower than the Bank of England forecast in future years.

4 This gap appears to be partially driven by a divergence between the Office for National Statistics' National Accounts measure of general government pay (included in the OBR's measure of wages) and public sector average weekly earnings (included in the Bank of England's measure of wages).

FIGURE 4: **The OBR typically forecasts slower wage growth than the Bank of England**

Difference between contemporaneous OBR and Bank of England annual nominal wage growth forecasts, by forecast date: UK



NOTES: The OBR and Bank of England do not release forecasts at exactly the same time. The chart shows, for each OBR forecast, the gap to the nearest Bank of England forecast; for example, the OBR March 2015 forecast is compared to the Bank of England's February 2015 forecast. No gap between forecast dates is greater than a month. The definition of wage growth used by the OBR and Bank of England differ (the Bank of England forecast is based on Office for National Statistics data for Average Weekly Earnings, whereas the OBR uses a National Accounts definition of wages per employee).
SOURCE: RF analysis of OBR, Historical Official Forecasts database; Bank of England, Monetary Policy and Inflation Reports (various)

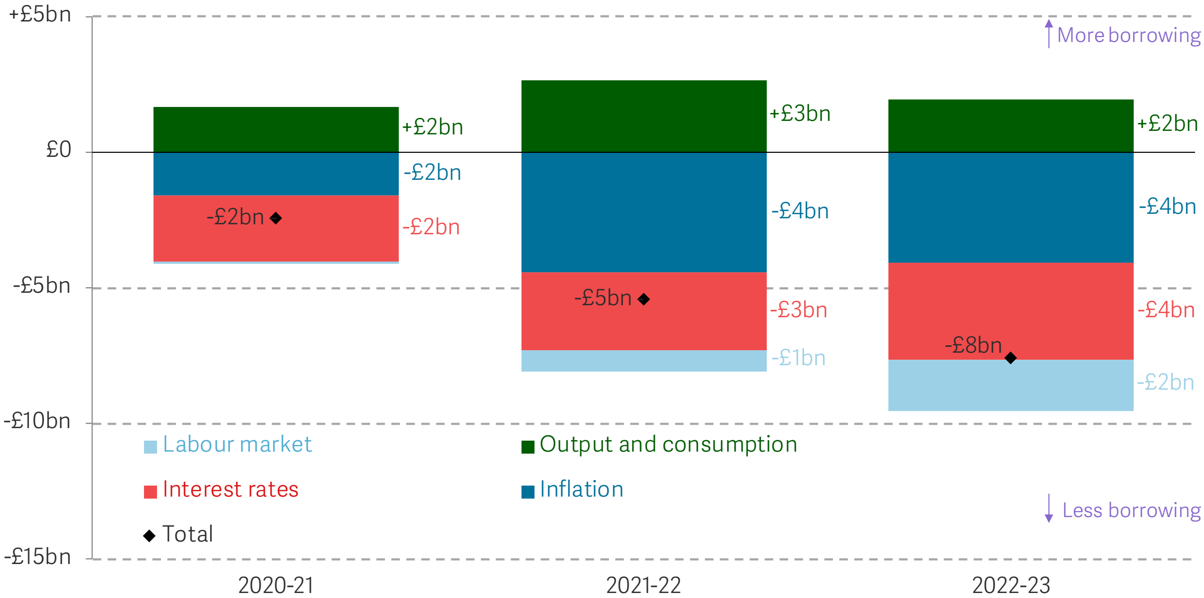
A major challenge for the OBR will be how to incorporate the economic impacts of Brexit. Their previous forecast was released the day before the Commons vote which led to the extension of Article 50 beyond 29 March 2019. Since then, there has been a change in prime minister, an election, a reworking of the post-Brexit regulatory and customs position of Northern Ireland, and shifting priorities for the final EU-UK relationship. With current government policy targeting a "comprehensive" trade agreement to be in place by 2021, a position which will not replicate the current frictionless trading relationship, uncertainty will be elevated for households and businesses throughout 2020. The OBR will need to come to a view on the economic effects of additional uncertainty in the near term, and on the impact of likely increased trade barriers in the longer term. In practice, the impact on the forecast is likely to be limited. This is because while the new government envisages a less close relationship than Theresa May sought, the transition period end date is unchanged from that underpinning the previous forecast. In addition, the stated goal of government policy on the future relationship remains a comprehensive free trade agreement.

Despite uncertainty, lower inflation, lower interest rates and a resilient jobs market represent good news for the public finances

What, then, will the OBR's economic forecasts mean for the government's finances? Our best estimate is shown in Figure 5. This is based on a model using a granular breakdown of the 'fiscal ready reckoners' published by the OBR. These link changes in individual economic series, for example RPI inflation or house prices, to changes in government spending and taxation.[5]

FIGURE 5: **Government borrowing is expected to be lower as a result of falling interest rates and inflation**

Estimated change in the OBR's forecast for public sector net borrowing, by economic driver: UK



NOTES: See footnote 5 for details of modelling assumptions.
SOURCE: RF analysis of OBR; Bank of England

The best estimate for the change in forecasted borrowing (before government policy changes) is a reduction of £8 billion. The two largest contributors are inflation and interest rates; these are both lower than previously expected and this reduces the estimated cost of financing government debt by around £4 billion each by 2022-23. There is a small upward contribution to borrowing from reduced expectations for GDP and consumption, which lower expected corporation and VAT tax receipts – equating to an additional £2 billion of borrowing. The final component is that slightly higher employment leads to greater income tax receipts.

5 For this purpose, we have constructed an updated economic forecast based on the Bank of England's January 2020 Monetary Policy Report expectations, with the exception that we have included a scenario which entails no revision to the more pessimistic OBR forecast for wage growth, for the reasons discussed above. Not all economic series that are needed as inputs into our model are provided by the Bank of England. In these cases, we have calculated scenario-consistent estimates based on historical relationships and economic judgement.

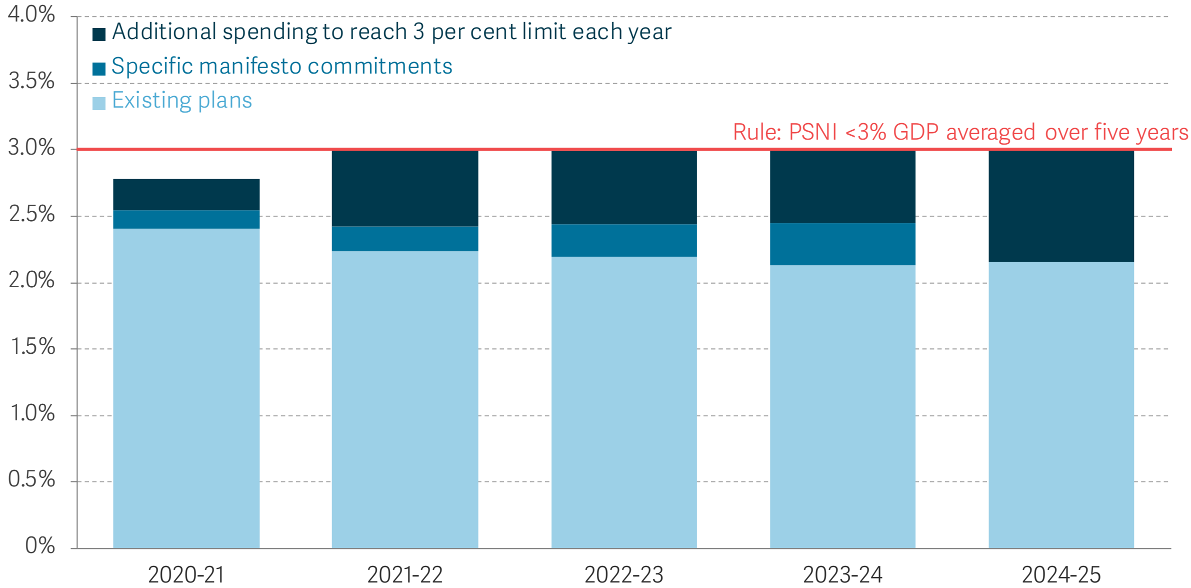
This estimate is subject to a reasonable level of uncertainty. One particular area of uncertainty relates to the pace of wage growth. Our central expectation for the change in borrowing (signified by the black diamonds in Figure 5) is based on no upward revision to earnings growth, reflecting the OBR's consistently more pessimistic take than the Bank of England's. But a more optimistic wages forecast, in line with the Bank of England's expectations, could increase income tax receipts and lower welfare spending, leading to a reduction in borrowing of a further £6 billion.

The government is likely to substantially boost investment

But what does all this mean for the policies set to be announced in the Budget? The first thing we know is that the government intends to substantially boost investment. The Conservative manifesto included a new fiscal rule allowing public sector net investment to "go up to 3 per cent of GDP, averaged over the standard five-year forecast horizon". The accompanying costings document highlighted the £80 billion capacity for additional investment over the next four years. Figure 6 presents a possible spending path for additional government investment that would keep net investment at or below 3 per cent of GDP in each year, at the same time as roughly matching cumulative investment spending totals stated in the manifesto.

FIGURE 6: **Public sector investment is expected to pick up substantially**

Public sector net investment as a proportion of GDP, fiscal rule and forecast: UK



NOTES: Due to the time it takes to get investment projects underway, we have assumed that the increase in investment in 2020-21 amounts to half the gap between existing plans and the 3 per cent limit.
SOURCE: RF analysis of OBR, Restated March 2019 forecast, December 2019; OBR, Economic and Fiscal Outlook, March 2019; Conservative Party Manifesto, November 2019

In practice, it will be difficult for the government to immediately increase net investment spending from the baseline of a little over 2.5 per cent of GDP in 2020-21 up to the full 3 per cent limit. Indeed, the specific spending commitments in the manifesto only came to an additional 0.1 per cent of GDP in 2020-21, rising to 0.3 per cent in 2023-24. Therefore, we have assumed that a feasible increase in investment in 2020-21 would be half of the gap between existing plans and the 3 per cent limit. The OBR will assess the likelihood of the government meeting its investment plans, and could include a prediction of the government's possible underspend on investment in 2020-21 if they do not deem plans credible. Because the manifesto implied that additional investment could be as much as £100 billion over the life of the parliament, if the government were to fail to reach the 3 per cent limit immediately, they could choose to overshoot this level in subsequent years.[6] Conversely, the government may not be able to sustain this higher steady-state level of investment. An under- or over-shoot, in any given year, relative to our assumed investment profile shown in Figure 6, would affect some of the subsequent analytical conclusions in this report. A further pre-Budget report from the Resolution Foundation will explore what approach the government should take on public investment.

Economic revisions and additional investment plans indicate rising borrowing and barely falling government debt

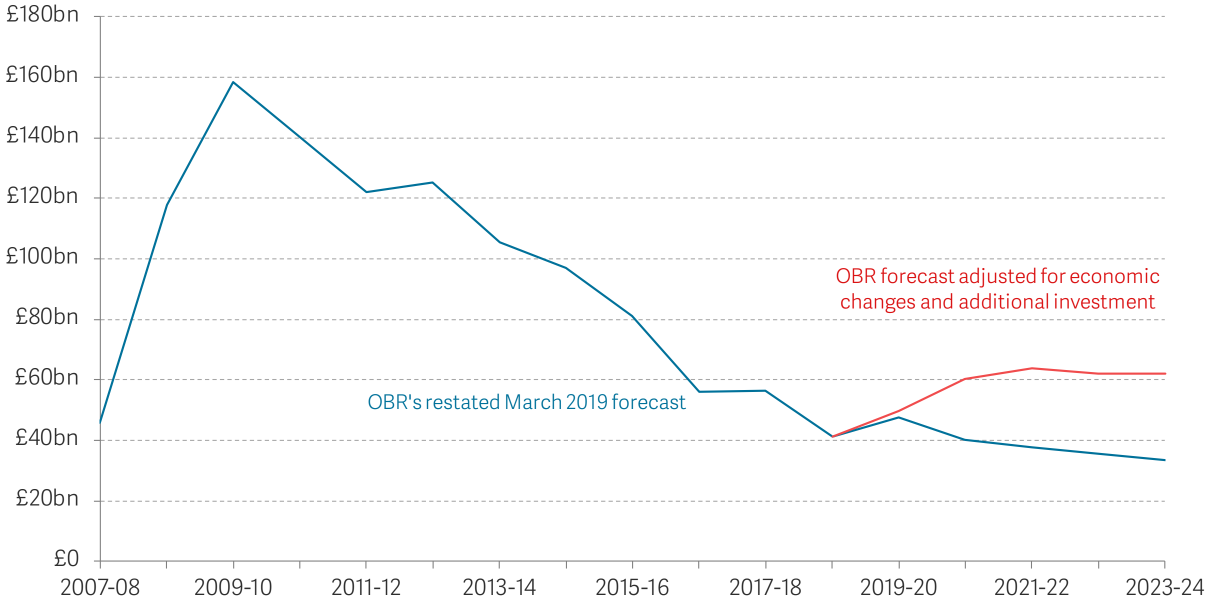
Figure 7 puts the extra borrowing from the additional investment in perspective. Accounting for the additional investment plans and changes to the borrowing forecast due to the shifting economic forecast (as well as policy changes announced since March last year, discussed below), we see that public sector net borrowing is expected to gradually increase. While the scale of additional borrowing is relatively modest, this would be the first sustained increase in borrowing since the financial crisis and takes place even given expected improvements to the underlying macroeconomic environment.[7]

6 The manifesto included the commitment to "invest £100 billion in additional infrastructure spending", although no time period was specified. In addition to this, the manifesto costings document included the observation that "these new rules make possible approximately £80 billion in additional capital spending over the next four years, 2020-24 (and £100 billion over five)", and that while not all of this had been allocated in the manifesto, "further detail [would] be set out by the Chancellor at Budget".

7 This picture is very different to the pre-EU referendum forecast, when the OBR expected the government to have a *surplus* of £11 billion by 2020-21, rather than borrowing of £47 billion.

FIGURE 7: **Investment plans push borrowing up to 2016 levels**

Public sector net borrowing (nominal), outturn and forecast: UK



NOTES: Figures for 2019-20 onwards are forecasts, prior to that outturn data is shown. The OBR-restated forecast is the March 2019 forecast adjusted for statistical revisions from the Office for National Statistics. The red line includes changes to borrowing implied by Spending Round 2019 and the Conservative Party manifesto – these are outlined further below.
SOURCE: RF analysis of OBR, Restated March 2019 Forecast, December 2019

Figure 8 shows that prior to the election, the OBR expected net debt to fall substantially as a proportion of GDP, from 81 per cent in 2019-20 to 73 per cent in 2023-24. However, over half of this fall was a result of the withdrawal of the Term Funding Scheme by the Bank of England. If we remove this effect and include the additional borrowing detailed above, the expectation is that debt would increase as a proportion of GDP over the forecast period, by 0.2 per cent. And debt will remain well above the prevailing level prior to the financial crisis. The government is, in practice, already pursuing a debt stabilisation, rather than reduction, strategy.

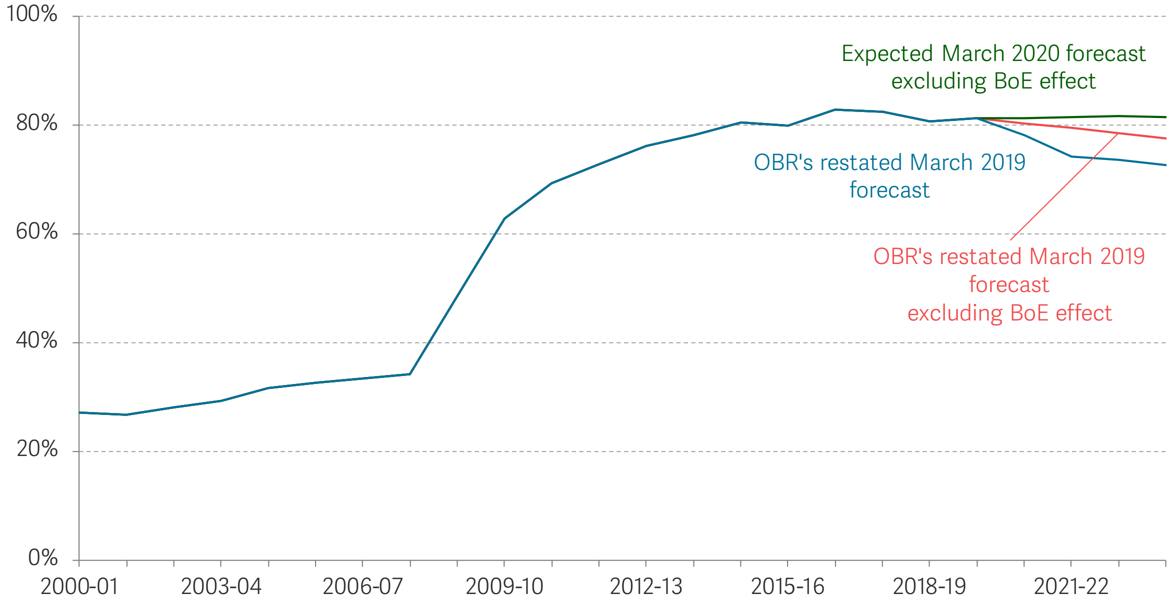
This brings us onto the government's wider fiscal rules that are significantly more constraining than their investment limit. The manifesto laid out two. First, to balance current (i.e. excluding investment) spending and tax receipts. And second, to keep the cost of financing interest on government debt below 6 per cent of tax revenues, and failing this to ensure debt does not rise over the course of the parliament.[8] The accompanying manifesto costings document stated that the rule to reach a current balance should be met by "no later than the third year of the forecast". There is no guarantee that the new Chancellor will choose to stick with his predecessor's plans –

8 If the debt interest limit is breached, this triggers an additional requirement for government plans to be adjusted to ensure debt is stable or falling.

something we return to later in this paper – but for this initial analysis we assume that the government will adopt fiscal rules in line with those set out in the manifesto just three months ago.

FIGURE 8: **Public sector net debt would barely fall without changes driven by the Bank of England**

Public sector net debt as a proportion of GDP, outturn and forecast: UK



NOTES: Figures for 2019-20 onwards are forecasts, prior to that outturn data is shown. The OBR restated forecast is the March 2019 forecast adjusted for statistical revisions from the Office for National Statistics. The red and green lines include changes to borrowing implied by Spending Round 2019 and the Conservative Party manifesto – these are outlined further below.
SOURCE: RF analysis of OBR, Restated March 2019 Forecast, December 2019

Given the low level of interest rates, the debt interest limit is not a binding constraint on the government for the upcoming Budget. In 2018-19, central government debt interest (net of the Asset Purchase Facility) was just 4.6 per cent of public sector receipts. The spot nominal gilt rate for a bond of average outstanding maturity is only around 0.75 per cent. Therefore, extra debt would need to be in excess of £1 trillion for this rule to be breached. This is not to say this rule is irrelevant, as changes in interest rates and inflation can quickly change the government's interest payments, but it will not define how the government approaches policy decisions in this Budget.[9]

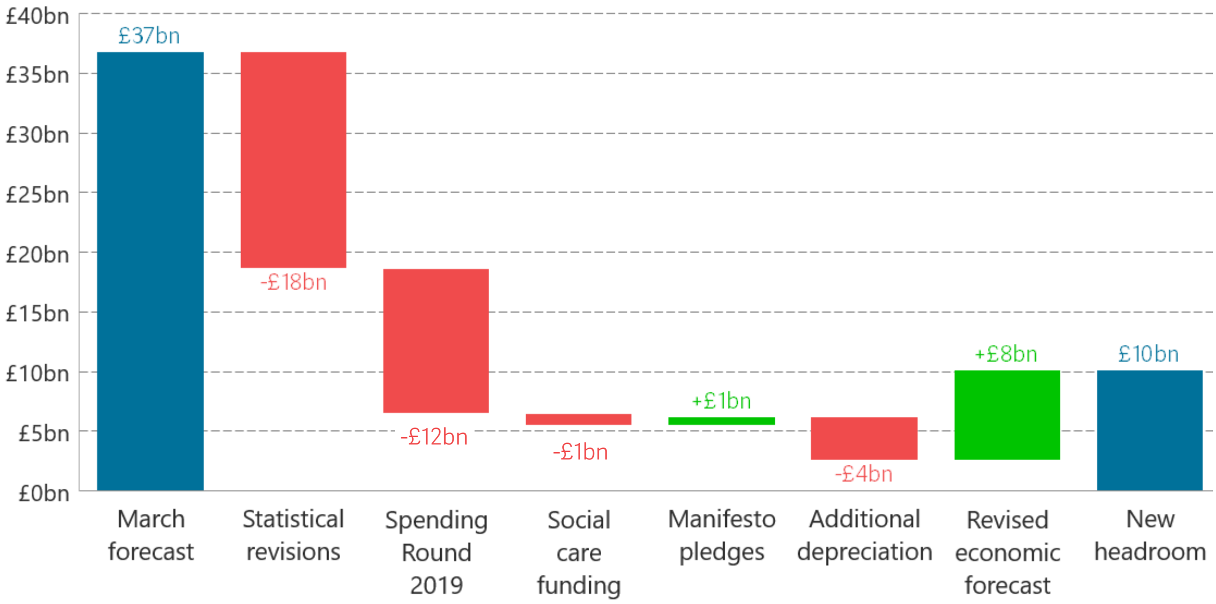
9 For more detail on the dynamics of debt interest fiscal rules, see: R Hughes, J Leslie & C Pacitti, Britannia waives the rules?: Lessons from UK and international experience with fiscal rules, Resolution Foundation, October 2019

The government's headroom on its main fiscal rule would have all but disappeared, were it not for revisions to the economic forecast

The final rule in the manifesto, to balance current spending and taxes by 2022-23 (the 'current balance' rule, which excludes borrowing for investment spending that is included in Figure 7) is the key constraint on the government. Figure 9 shows how the headroom (the amount of additional spending or reduced taxes the government could afford before breaching this rule) has changed since the Spring Statement in 2019.

FIGURE 9: **Fiscal headroom has fallen by more than two-thirds since March 2019**

Changes in headroom against the current balance rule: UK, 2022-23



NOTES: Additional depreciation is calculated as the depreciation of the assumed extra gross investment using the observed 2018-19 depreciation rate. It also includes a small extra amount capturing the interest on the additional borrowing for the investment.
SOURCE: RF analysis of OBR, Restated March 2019 forecast, December 2019; OBR, Economic and Fiscal Outlook, March 2019; Conservative Party Manifesto, November 2019

Based on the March 2019 forecast, the government had a headroom of £37 billion against the current budget rule, but around half of this was taken away as a result of changes made by the Office for National Statistics (ONS) – particularly in terms of the treatment of student loans.[10] The government then laid out a substantial settlement of £12 billion of additional spending as part of the 2019 Spending Round and £1 billion of additional funding for social care. This left the fiscal headroom at just £5 billion going into the election. The manifesto was cautious and did not contain substantial additional current spending or taxation pledges; the net result was a minor increase in the headroom of

10 Those student loans that will not be paid back (i.e. written off in future) are now assumed to count in today's current spending. There were a number of other more minor changes including an updated approach to calculating depreciation, and a correction to corporation tax receipts.

£1 billion. However, this increase is more than offset by the additional depreciation and interest costs from the additional investment spending assumed in Figure 6, above. The final factor is the revised economic forecast which, as set out above, could raise the headroom by around £8 billion. In total this leaves the government with a predicted headroom of £10 billion, less than a third of the headroom a year ago.

The remaining fiscal headroom is the bare minimum needed to maintain credibility

The government might be tempted to treat the presence of any fiscal headroom as a good-news story, and something that allows additional borrowing today for current spending. However, one of the key lessons from the UK's experience of fiscal rules over the past two decades is that, if rules are to be met in practice, they need to include plans for possible deteriorations in the economic or fiscal outlook. And to do this, governments need to maintain headroom that is at *least* as large as our estimates suggest they will have in this Budget. As Figure 10 shows, the £10 billion headroom is both low relative to the typical headroom left by Chancellors when they have introduced new rules, and is only a third of the average revision to the OBR's typical borrowing forecast over three years. Put differently, if forecasts are revised over time as has been typical since 2010, the government might need to find almost £19 billion of tax rises or spending reductions to ensure that the current balance rule is met – even if they do not 'use' any of the £10 billion of headroom in this Budget.[11]

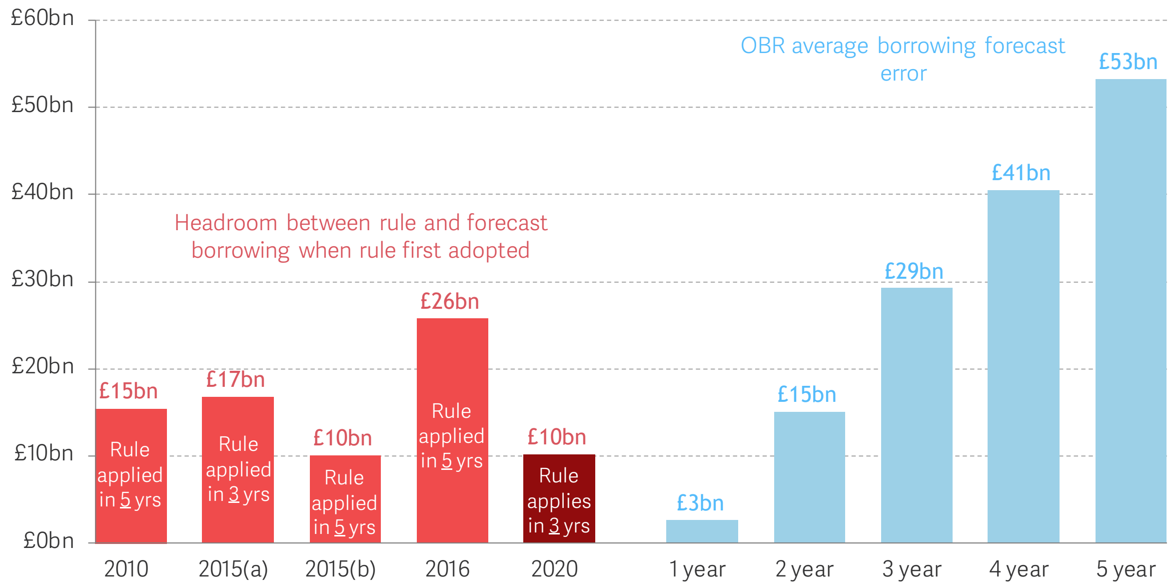
The efficacy of fiscal rules – in helping to improve the economic policy-making of the government and communicating to financial markets a commitment to sound government finances – relies on a credible approach to meeting them. Without this, they become less helpful for the government in setting spending plans for departments or lowering interest costs.[12] Therefore, at the very least, a responsible approach to fiscal policy would be to keep the predicted fiscal headroom intact.

11 The forecast error partially reflects the government's tendency to plan to operate tighter fiscal policy in the future than they do in practice; so, the £19 billion of tax rises or spending restrictions needed to add to the existing £10 billion headroom to reach the average £29 billion forecast error could be met with foregone fiscal loosening.

12 For further discussion, see: R Hughes et al., Totally (net) worth it: The next generation of UK fiscal rules, Resolution Foundation, October 2019

FIGURE 10: **£10 billion of headroom is low relative to the typical forecast adjustment**

Headroom of fiscal rules at introduction and average borrowing forecast errors: UK



NOTES: 2020 rule is based on the commitment in the costings document accompanying the Conservative Party manifesto to balance current spending and taxation within three years. The average of forecast errors is calculated as the mean change in the borrowing forecast since the OBR's creation in 2010.
SOURCE: RF calculations of OBR, Historical official forecasts database and Fiscal risks report, July 2019

Austerity fatigue is clear in both public services and government departments

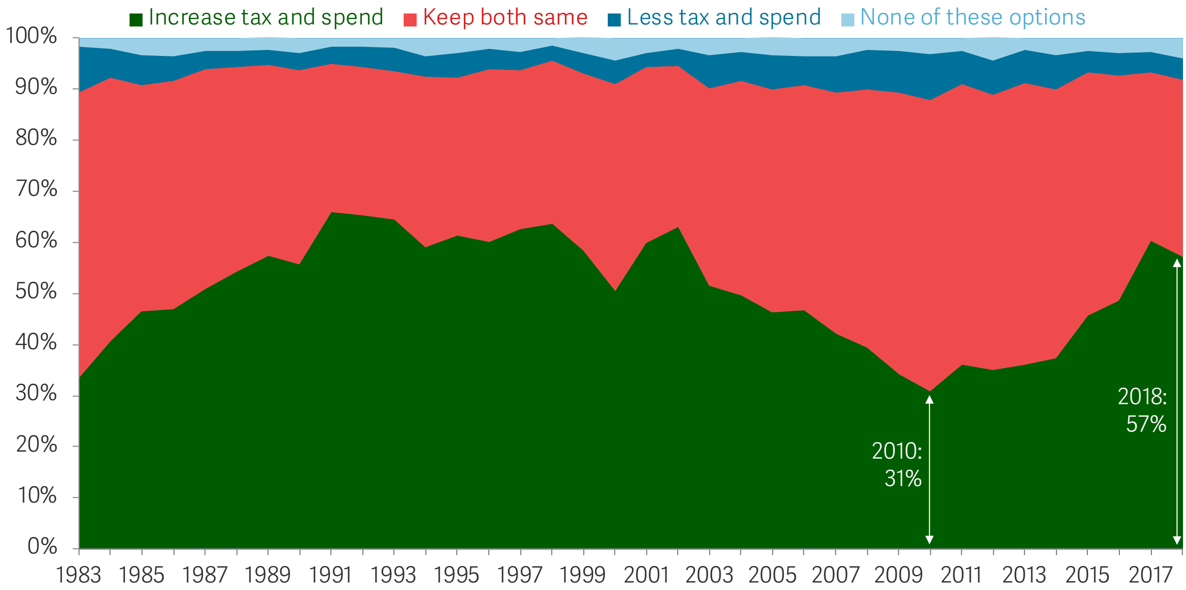
For the Conservative party in the 2010s, spending and tax cuts were the order of the day. As David Cameron said in the 2015 Queen's Speech debate: "We have made the choice that we will make savings in public spending in order to keep taxes down. That is the right choice and it was backed by the British people in the election."[13]

But the view of the British people has since shifted. Public support for increases in spending and taxation is near record highs in Great Britain, with 57 per cent of adults favouring this option over keeping both the same (35 per cent), or reducing both spending and taxation (4 per cent). As shown in Figure 11, the level of support for 'tax and spend' is now almost twice as high as in 2010, when just 30 per cent of adults were supportive of such an approach.

13 D Cameron, House of Commons: Debate on the Address, Hansard, May 2015

FIGURE 11: **Support for increases in spending and taxation is near record highs**

Proportion of adults in favour of various options in relation to tax and spend: GB



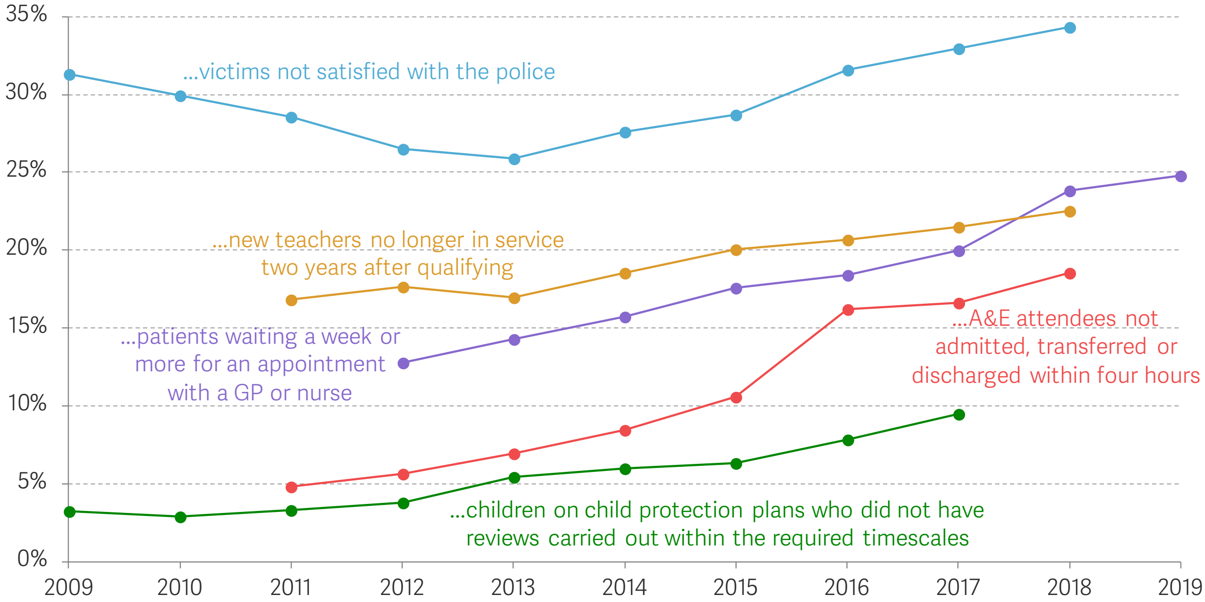
SOURCE: RF analysis of Centre for Comparative European Survey Data; NatCen, British Social Attitudes Survey

This change in the national mood is understandable given the deterioration in public service performance metrics. As Figure 12 shows, many public services are suffering from a severe case of austerity fatigue. The proportion of crime victims declaring themselves dissatisfied with the police increased from 26 per cent in 2013-14 to 34 per cent in 2018-19.

Likewise, the proportion of new teachers leaving the profession within two years of qualifying increased from 17 per cent in 2011 to 23 per cent in 2018. And, despite protection for health spending, the proportion of patients waiting a week or more for a GP or general practice nurse appointment increased from 13 per cent in 2012 to 25 per cent in 2019. Similarly, the proportion of accident and emergency attendees not admitted, transferred or discharged within four hours jumped from 5 per cent in 2011 to 24 per cent in 2019.

FIGURE 12: **A range of public services are showing signs of strain**

Proportion of...: England

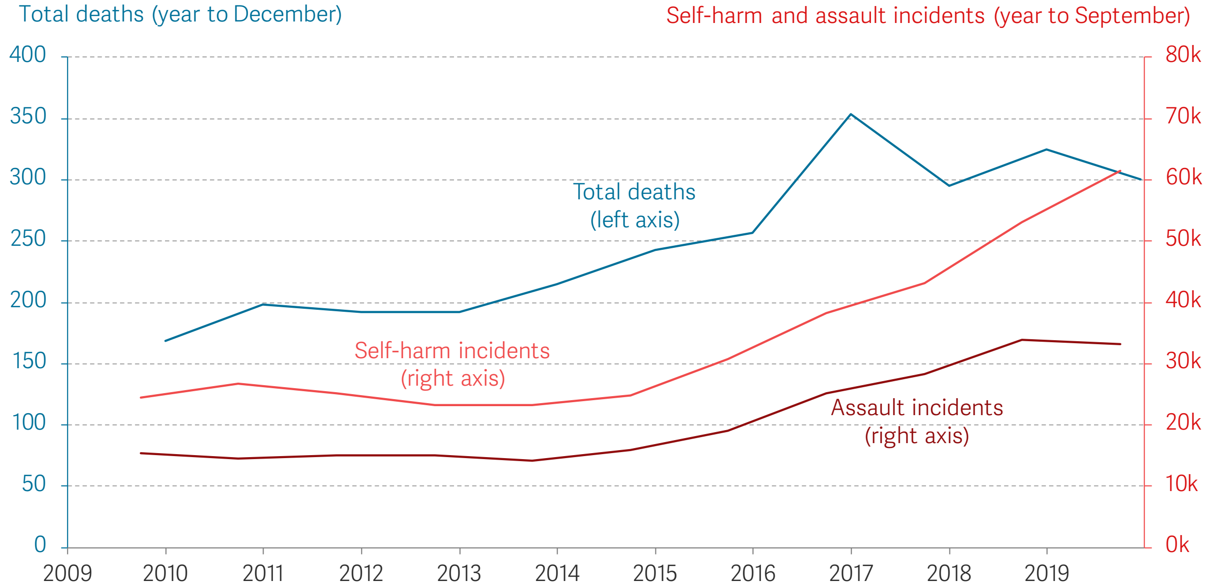


NOTES: Data on victims not satisfied with the policy covers England and Wales. Victims not satisfied with the police and child protection figures are for financial years. A&E figures are 12-month averages for Type 1 attendances.
SOURCE: Institute for Government, Performance Tracker

It's not just public-facing services where austerity has taken its toll. In some areas, such as prisons, the effect of austerity may not be plain for all to see – but is clearly evidenced. The number of deaths, self-harm incidents and assaults in prisons has increased, particularly over the past five years. There were 100 more deaths in prisons in 2019 than in 2010, with the number of assaults and self-harm incidents up 130 per cent on the level reported in 2010, as shown in Figure 13.

FIGURE 13: **The impact of austerity on prisoner safety is clear**

Number of deaths, assaults and self-harm incidents in prisons: England and Wales



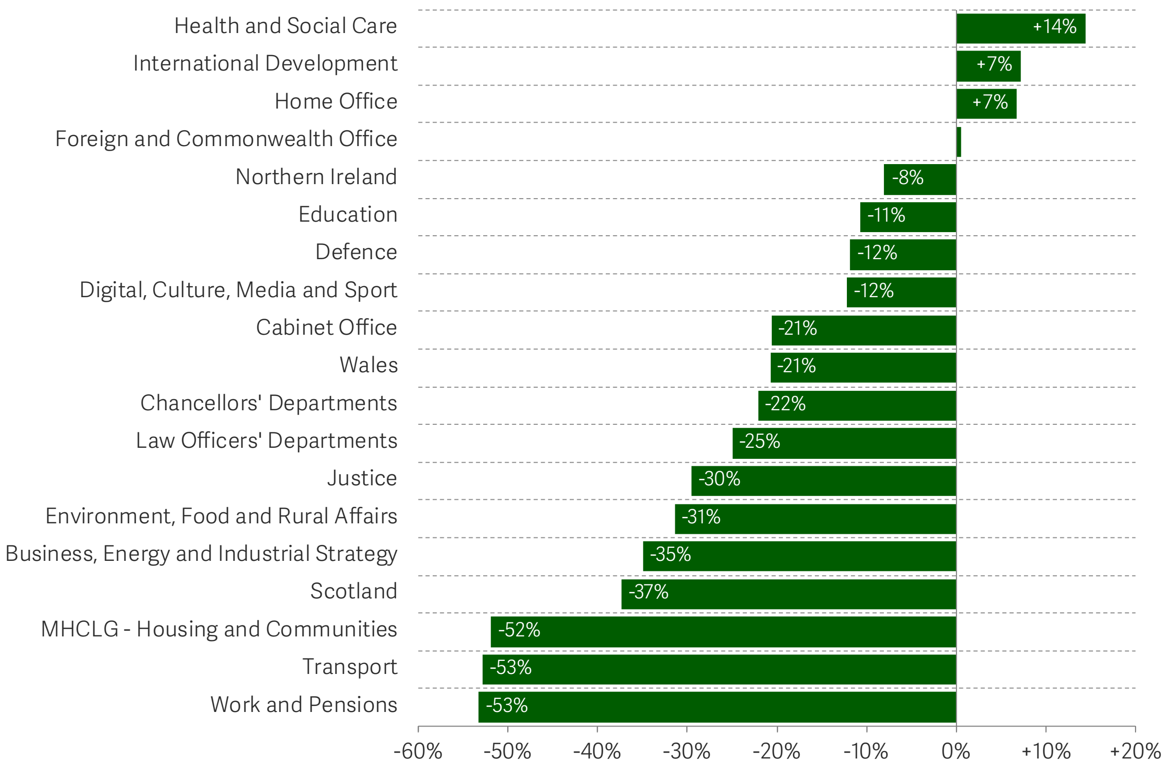
NOTES: 2019 data are provisional.
SOURCE: RF analysis of Ministry of Justice, Safety in Custody Statistics

In real terms per capita, the Ministry of Justice's day-to-day spending budget (resource departmental expenditure limited, or RDEL) has been cut by 30 per cent since 2009-10, which is broadly in line with the average of the scale of reductions in departmental spending over the past decade. As Figure 14 shows, some unprotected departments have had even larger cuts to their budgets over this time period. For example, the departments for Work and Pensions and Transport have had their day-to-day spending cut by more than half since 2009-10.

Of course, not all departments have faced cuts: the Department for Health and Social Care's (DHSC's) budget has increased by 14 per cent in real per-capita terms over the past decade. But overall, the large cuts to a number of Whitehall departments and the evidence on a range of public services showing signs of strain help make sense of why public opinion has shifted decisively in favour of higher spending over recent years.

FIGURE 14: **Austerity may have ended, but its impact on departmental budgets is far from reversed**

Cumulative real (GDP deflator-adjusted) change in per-capita resource departmental expenditure limits: UK, 2009-10 to 2020-21



NOTES: Cash changes in RDEL as published at Spending Round 2019 added to PESA totals for 2019-20 to reach estimates for long-run changes. Figures are adjusted as far as possible to account for machinery of government changes.
SOURCE: RF analysis of HM Treasury, PESA, various; HM Treasury, Spending Round 2019, September 2019

The Conservatives are no longer the party of spending cuts, with spending set to increase in the years ahead

Along with the public, government policy on state spending has certainly changed as we move into the 2020s. In 2015, the Conservative manifesto mentioned the 'deficit' 17 times, whereas in 2019 it received just one mention.[14] The Prime Minister now talks proudly of giving the NHS 'the biggest cash injection in history', rather than agonising over the need to make the service more efficient.[15]

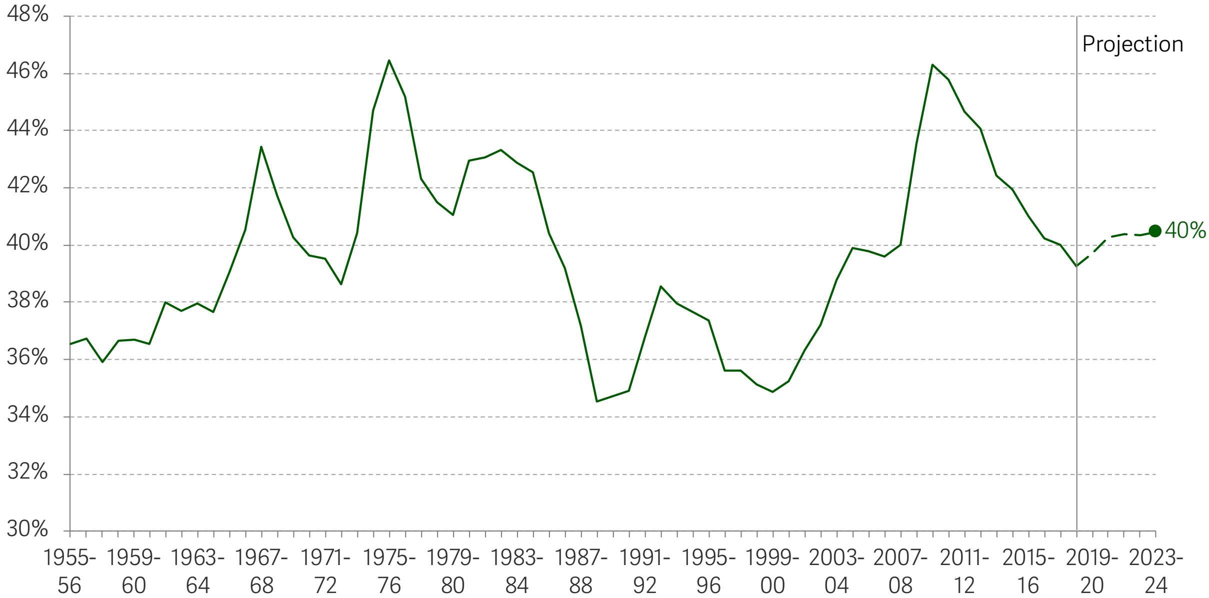
The first sizeable move towards a significantly new approach to public spending took place in the 2019 Spending Round, which set out the fastest increase in day-to-day departmental spending since the early 2000s.[16] Subsequently, the Conservative election

14 Resolution Foundation, The choice facing Britain: What the manifestos reveal, November 2019
15 B Johnson MP, Prime Minister's New Year's message, December 2019
16 A Corlett et al., Rounding up: Putting the 2019 Spending Round in context, Resolution Foundation, September 2019

manifesto pledged additional current spending items, as well as the very large increase in capital spending discussed above. These pledges suggest that, as with borrowing, a corner has been turned, with overall government spending set to increase from 39 per cent of GDP in 2018-19 to 40 per cent of GDP in 2023-24, as shown in Figure 15. On these plans, 2023-24 looks set to be a milestone year for public spending in the UK, with total managed expenditure (TME) passing the £1 trillion mark for the first time in our history.

FIGURE 15: **Even before new commitments in this Budget, spending is set to rise over the first half of the 2020s**

Total managed expenditure as a proportion of GDP: UK



NOTES: The OBR's restated March 2019 forecast provides the baseline for public spending in this analysis, with Spending Round 2019 and manifesto commitments added – including a back-loaded profile for £80 billion of capital spending over the period 2020-21 to 2023-24. Static effect, not accounting for fiscal multipliers.
SOURCE: RF analysis of OBR, Public Sector Finances Aggregates Databank, December 2019; ONS, Nominal GDP (BKTL); HM Treasury, Spending Round 2019, September 2019; Conservative Party manifesto November 2019

This shift in approach marks a substantial change for a traditionally small-state Conservative party. For example, Rishi Sunak said in Parliament in 2015 that his view was that "public spending should not exceed 37 per cent of GDP" inside of normal times.[17] And it comes before other pledges – such as increases in schools spending in the years beyond 2020-21 – are accounted for.

In headline terms, real departmental 'resource' spending (RDEL) is now just 3 per cent below its 2009-10 level, and is on track to return to this peak by the end of the likely Spending Review period, in 2023-24. But, population growth means that this statistic is a poor measure of how reductions in public spending feel – and how much they are

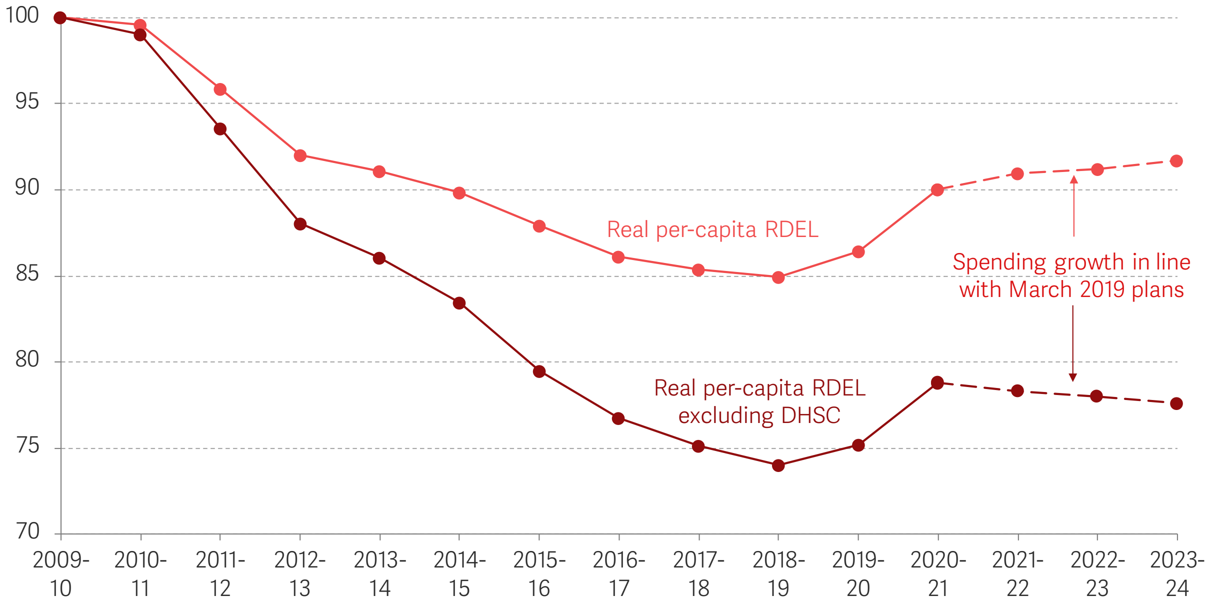
17 R Sunak, Speech in the House of Commons, Hansard, July 2015

noticed across the country. Further, the NHS spending increases over the 2010s mean its budget accounts for a larger share of overall RDELs (spending by the DHSC now accounts for almost £4 in every £10 of resource spending by departments, up from £3 in every £10 in 2007-08), so it's also instructive to remove this from the totals to get a more accurate sense of how budgets across the rest of Whitehall have fared.

Figure 16 tracks real RDEL spending per capita from 2009-10, both including and excluding the DHSC budget. The low-point for both measures occurred in 2018-19, by which time overall real RDEL per capita had fallen to 85 per cent of its 2009-10 level, and to 74 per cent of its 2009-10 level excluding health spending. The 2019 Spending Round decisively reversed this trend, with around one-third of cuts to day-to-day departmental spending per capita set to have been reversed by 2020-21, or one-fifth of cuts to non-health budgets.

FIGURE 16: **Around one-third of departmental austerity has been reversed, or one-fifth if health spending is excluded**

Index of real (GDP deflator-adjusted) per-capita resource departmental expenditure limits (2009-10 = 100), including and excluding Department for Health and Social Care (DHSC) spending: UK



SOURCE: RF analysis of HM Treasury, Spending Round 2019, September 2019; OBR, Economic and Fiscal Outlook, March 2019; OBR, Restated March 2019 forecast, December 2019

Although it has not formally set spending plans for the years beyond 2020-21, the government does have RDEL totals pencilled in for each year out to 2023-24. In Figure 16 the growth rates in these totals have been applied to the new higher level of RDEL as a result of the 2019 Spending Round and Conservative election manifesto commitments.

This provides an indicative path for RDEL spending over the next three years, absent further changes.

This reveals how the baseline for overall RDEL spending is set to increase in real per capita terms, driven by large increases in the NHS budget. Once these are removed, the spending profile of the non-NHS parts of Whitehall is flat in real terms – but falling once we take account of population growth.[18]

This year the government will make big decisions about the future path of public spending

Across the three fiscal events that we expect to take place this year (the Spring Budget, Spending Review and Autumn Budget) the government will set the outline of, and then the detail for, public spending to the middle of the decade, alongside the wider tax and borrowing policies required to make that a reality.

The Chancellor has a decision to make as to whether he will set the Spending Review envelope (the firm spending totals that the Spending Review will then allocate between departments) at Spring Budget 2020 or wait until later in the year.

There are significant advantages to guiding the forthcoming Spending Review process by providing the clarity of a fixed envelope, but doing so will mean confronting the trade-offs inherent in any budget-setting process. In particular, a final decision about the scale of additional spending the government wants to see would require clarity about the tax rises or higher borrowing it would entail.

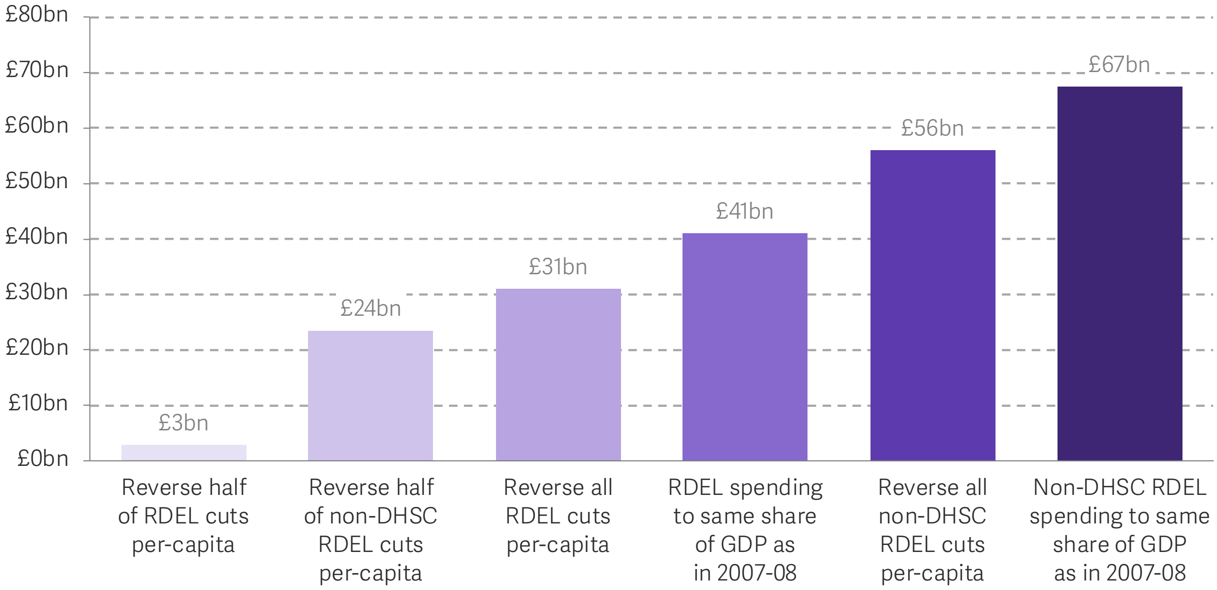
Regardless of which point in the year it happens, the size of the spending envelope set will depend on the government's view of what is desirable when it comes to reversing – not just ending – austerity.

Figure 17 sets out a wide range of estimates for the amount of additional current spending required to reverse austerity in Whitehall departments to varying degrees, and on various metrics.

18 Other parts of government such as the Department for International Development and the Ministry of Defence have budgets that (so long as economic growth does not falter) are set to grow faster than the average forecast presented here in the years ahead. Removing these departments from the analysis presented in Figure 16 would lead to projected non-health spend falling further still in the 2020s.

FIGURE 17: **The cost of reversing austerity depends on which measure you use, and the extent of the government's ambition**

Increase in resource departmental expenditure limits required in 2023-24 to reverse austerity in real terms (GDP-deflator adjusted to 2020-21 prices) per-capita or relative to GDP: UK



NOTES: 'RDEL cuts' here refers to the reductions in RDEL as shown in Figure 16 above, calculated on a real-terms per-capita basis.
SOURCE: RF analysis of HM Treasury, Spending Round 2019, September 2019; OBR, Economic and Fiscal Outlook, March 2019; OBR, Restated March 2019 forecast, December 2019

At the bottom end, it would require just an additional £2 billion of spending for half of the per-capita cuts to departmental budgets to be reversed by 2023-24, or an additional £24 billion to reverse half of the cuts to non-health departments. To fully reverse austerity on this metric, so that real terms per capita spending returns to its 2009-10 levels, would cost £31 billion overall, or an additional £56 billion for the same to be said of non-health budgets.

Alternatively, if day-to-day departmental spending were to return to its pre-financial crisis levels relative to the size of the economy, then an additional £41 billion would need to be allocated to departmental budgets. To return non-DHSC spending to its 2007-08 proportion of GDP would cost £67 billion.

This analysis highlights the scale of the challenge facing the new government in its objective of offering a clean break with the era of public spending restraint.

It's not just the public finances that have been affected by austerity, family finances have taken a hit too

Beyond departmental spending, what would it take for the austerity in family budgets deriving from large cuts to social security to feel like it has ended? In one sense, we're already well beyond that: it has been a while since Chancellors have announced welfare reductions at the dispatch box. Indeed, since the £14 billion of welfare cuts announced in George Osborne's 2015 Summer Budget, successive fiscal events have had the effect of increasing working-age social security spending by around £3 billion.[19]

But because of the nature of some of the cuts announced in 2015 – only applying to new claims made or new children born from April 2017 – a significant minority of these cuts are still in the process of being rolled out (indeed, some will take more than a decade to be fully implemented). As Figure 18 shows, the further roll-out of these cuts during the current parliament – most significantly the 'two-child limit' – will reduce working-age welfare spending by another £2.1 billion by 2023-24. Previous Resolution Foundation research has shown that almost another £2 billion will be added on top of that by the time they take full effect.[20]

What's more, while the benefits freeze (the largest component of the 2015 package of cuts) has now ended, none of its effects have been reversed. This is the challenging environment for lower-income households, and the backdrop to the roll-out of Universal Credit, which will itself create losers as well as winners.[21]

What would the cost be of making austerity in social security feel like it is over? The yardsticks should be some combination of: cancelling those phased welfare cuts that are still being rolled out; undoing what remains from the 2015 package of cuts in total spending terms;[22] and preventing expected increases in child poverty. A targeted package costing £5 billion (that includes scrapping the two-child limit and abolition of the family element) would arrest the child poverty increase from 2018-19 onwards.[23] More

19 The total cost of welfare cuts announced in the 2015 Summer Budget is estimated at £14 billion, somewhat higher than the costing at the time (closer to £12 billion), principally due to the benefits freeze saving more than expected due to higher-than-expected inflation. Increases in welfare spending since then include Universal Credit work allowance increases and the taper rate reduction, and the cancellation of the withdrawal of Housing Benefit from those aged under 21. For further details and costings, see: L Gardiner, The shifting shape of social security: Charting the changing size and shape of the British welfare system, Resolution Foundation November 2019

20 L Gardiner, The shifting shape of social security: Charting the changing size and shape of the British welfare system, Resolution Foundation, November 2019

21 For further details, see: L Gardiner & D Finch, The long and winding road: The introduction and impact of Universal Credit in Liverpool City Region and the UK, Resolution Foundation, January 2020

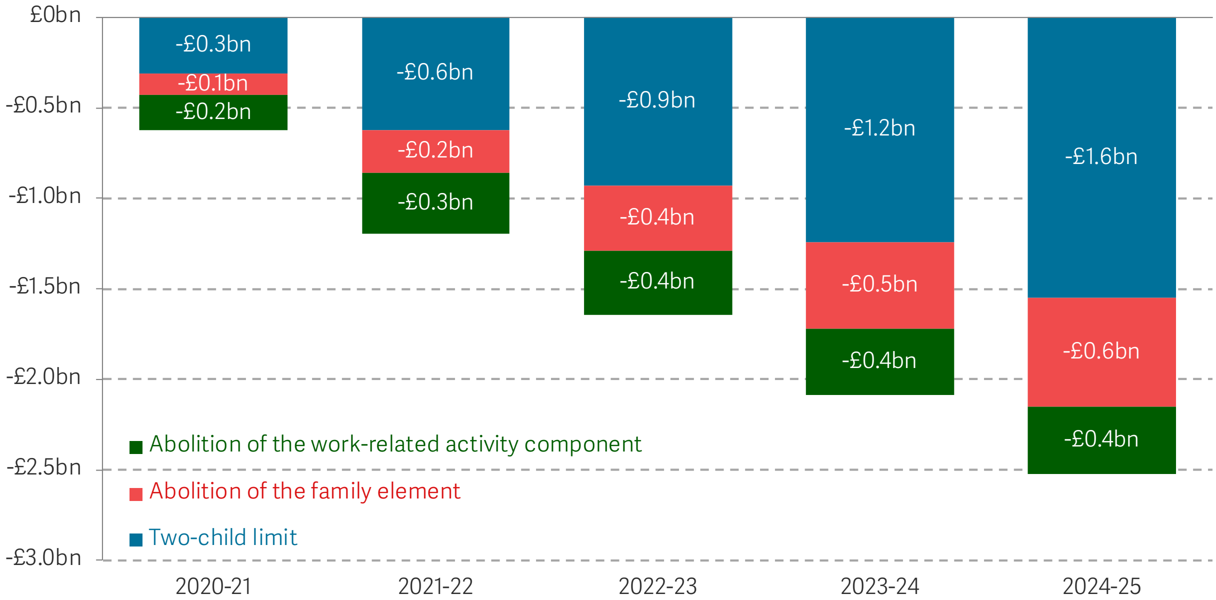
22 It should be remembered that these cuts came on top of approximately £19 billion of working-age welfare cuts delivered between 2010 and 2015. See: L Gardiner, The shifting shape of social security: Charting the changing size and shape of the British welfare system, Resolution Foundation, November 2019

23 A Corlett, The Living Standards Outlook 2019, Resolution Foundation, February 2019

ambitiously, closer to £10 billion would bring working-age welfare spending roughly back to its level absent the 2015 cuts, and bring child poverty roughly back to 2016-17 levels by 2023-24.[24]

FIGURE 18: **Working-age welfare cuts are continuing to bite**

Additional annual government saving over the course of this parliament from welfare cuts being phased in for new children / new claims: UK



NOTES: The abolition of the family element and two-child limit in tax credits, Housing Benefit and Universal Credit apply to children born from April 2017 onwards. The abolition of the work-related activity component in Employment and Support Allowance and Universal Credit apply to new claims made from April 2017 onwards.
SOURCE: OBR, Policy measures database, with RF adjustments and extrapolations

Taken together, then, a significant shift in policy on public services and social security comes with a price tag of several tens of billions of pounds.

The Prime Minister's public spending ambitions require a focus on tax-raising

The government's commitments to increase both capital and current spending combine to suggest that the path for public spending in the first half of the 2020s is almost certain to be higher than as set out in Figure 15. Not least, the Prime Minister has committed to 'levelling up' the UK (see Box 1), as well as finding a resolution for the crisis in social care funding during this year (a challenge that reflects the broader long-term funding pressures from an ageing population). An extra £1 billion has been added to local

24 L Gardiner, The shifting shape of social security: Charting the changing size and shape of the British welfare system, Resolution Foundation, November 2019

government budgets for 2020-21 and subsequent years for social care. But this is unlikely to be the end of the top-ups under the current system, and any future system will likely involve further increases in spending.

BOX 1: 'Levelling up' through current and capital spending

The government's main focus to date has not been on day-to-day departmental spending or family finances – though ultimately if it wants to make austerity feel a thing of the past, more spending will be needed in these areas. Rather, attention has been placed on the 'levelling up' agenda, which it seems is predominantly about allocating a large increase in capital spending to those parts of the country that have received a lower share of public investment in recent decades. This is a welcome development and, although an additional £100 billion of capital spending will be challenging to 'get out of the door' in the space of just five years, pushing up public investment to 3 per cent of GDP will bring the UK in line with average capital spending across developed economies.[25]

Levelling up using capital spending will not, though, be easy. First, because the long-term nature of capital spending doesn't allow for quick wins. Capital investment takes time to plan, build and implement. Although there will be examples of road or hospital upgrades in 'Blue Wall' areas that may be deliverable within relatively short time frames, they will likely be the exception rather than the rule. Investment can also be risky and take a long time to bear fruit.

For example, research and development (R&D) funding, which comprises one-third of the additional investment detailed in the Conservative manifesto, is set to increase in the coming years. The government could decide to locate the UK version of the 'Defense Advanced Research Projects Agency', announced in the Queen's Speech last year, in a location outside of the South East.[26] This may well have a large impact on the UK's productivity and dynamism in the long run, but it would be unwise to pin hopes on R&D spending increases being the means through which a tangible 'levelling up' of the country can take place within the space of just a few years.

Levelling up through capital spending will also be a big challenge for the government simply because the regional disparities in public investment in the UK are so big. For example, in

25 3 per cent (averaged over five years) is the ceiling on public investment in the fiscal rules proposed in the Conservative Party manifesto.
26 Prime Minister's Office, Queen's Speech December 2019 – background briefing notes, December 2019

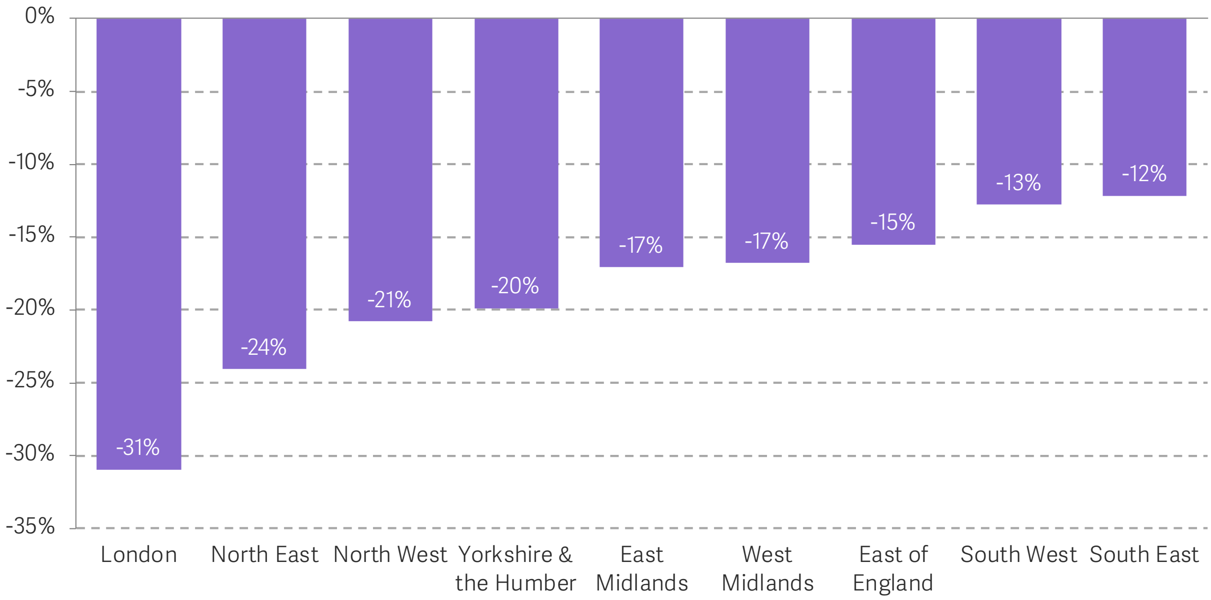
2017, government spending on R&D in the North East and North West totalled £216 million, almost three times smaller than the amount spent in the South East (£611 million). More broadly, capital spending is more than three times less evenly distributed than current spending across the regions of the UK, with a coefficient of variation for capital spending of 32 per cent, compared to just 11 per cent for current spending.

For these reasons, it may well be easier (notwithstanding the current balance fiscal rule) to level up – and have those who live in the parts of the country in which the Conservatives have just won a swathe of seats notice improvements in their area – through increases to current spending than capital investment.

Local councils, combined authorities and local police and fire services are the bodies responsible for many of the tangible changes in day-to-day life resulting from spending reductions since 2010, from the cleanliness of town centres to the number of libraries open nearby. Local spending has fallen across the board, with the largest average decline in real local spending (excluding education, due to the asymmetric effects of the Academy programme) per capita taking place in London (-31 per cent), as shown in Figure 19. Spending per capita in London had further to fall being significantly higher than average in 2009-10, at over £2,000 per person compared to a regional average of £1,300. Further, the capital's population has grown faster than elsewhere, with funding allocations not keeping pace.

FIGURE 19: **Local spending has fallen further in some of the parts of the country that are the focus of the 'levelling up' agenda**

Change in real (GDP deflator-adjusted to 2018-19 prices) local current spending per capita excluding education: England, 2009-10 to 2018-19



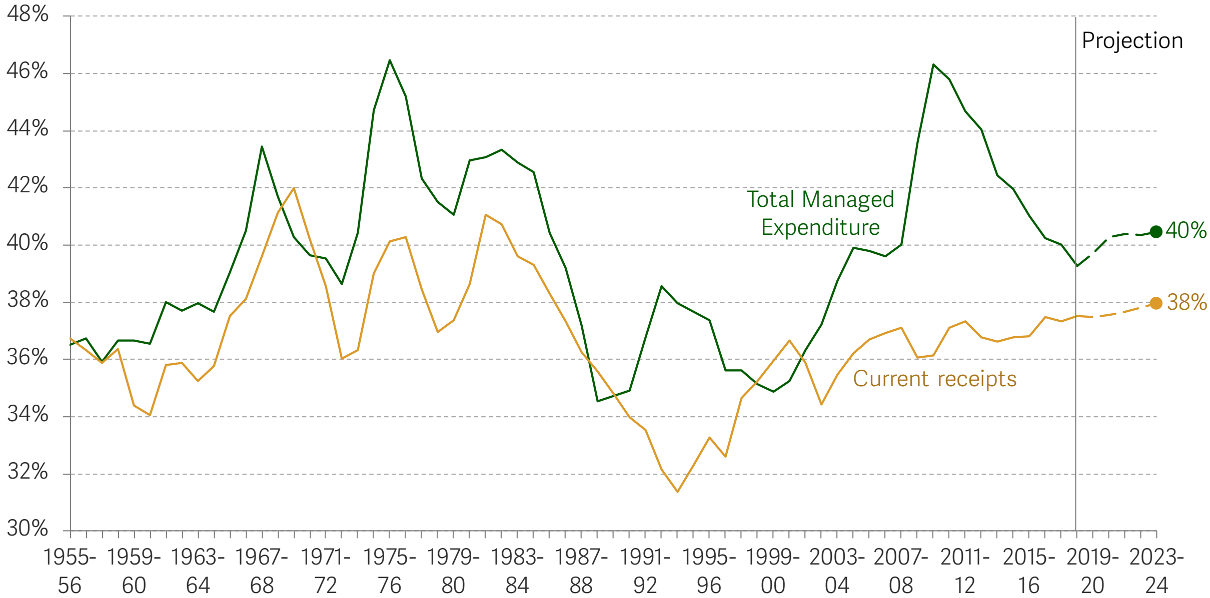
SOURCE: RF analysis of MHCLG, Local authority revenue expenditure and financing

The South East is the part of the part of the country where spending has fallen the least (-12 per cent). In contrast, many of the English regions that are the focus of the government's levelling up agenda have suffered larger falls. For example, in the North East local spending is down 24 per cent in real terms per capita, and in the North West a reduction of 21 per cent has taken place since 2009-10. Finding room in the Spending Review for increases in local spending may well be a helpful complement to the capital focus of the levelling up agenda.

The increase in borrowing discussed above reflects the fact that the gap between TME and public sector current receipts (PSCR) is set to be as wide in 2021-22 as it was in 2006-07, at just under 3 per cent, even before any additional spending increases are accounted for. This is shown in Figure 20.

FIGURE 20: **The gap between total spending and receipts is set to widen in the 2020s**

Total managed expenditure and public sector current receipts as proportions of GDP: UK



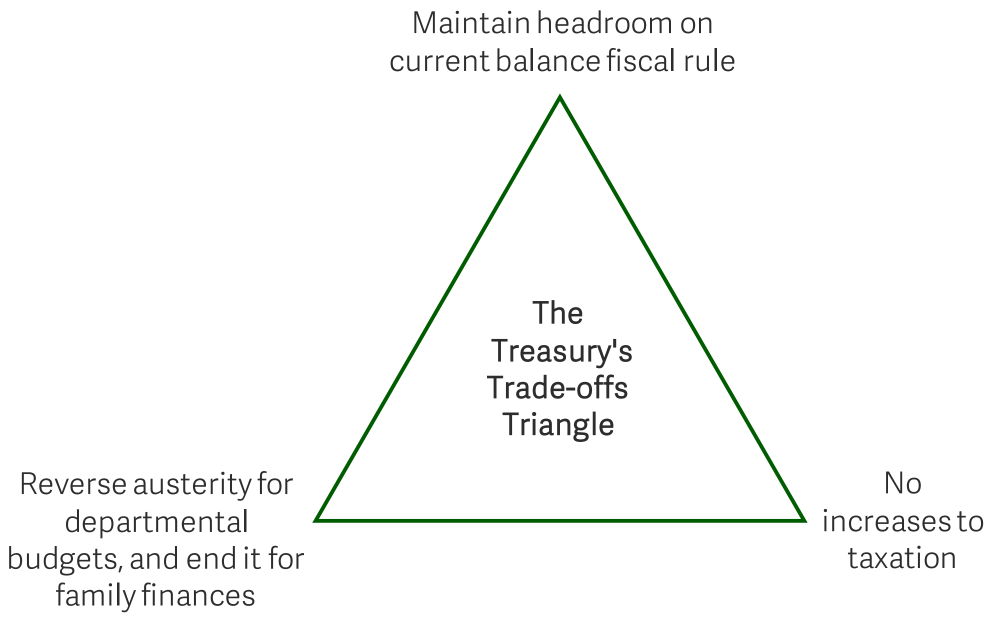
NOTES: The OBR's restated March 2019 forecast provides the baseline for public spending in this analysis, with Spending Round 2019 and manifesto commitments added – including a back-loaded profile for £80 billion of capital spending over the period 2020-21 to 2023-24. Static effect, not accounting for fiscal multipliers.
SOURCE: RF analysis of OBR, Public Sector Finances Aggregates Databank, December 2019; ONS, Nominal GDP (BKTL); HM Treasury, Spending Round 2019, September 2019; Conservative Party manifesto November 2019

This widening gap largely reflects the large increase in capital spending, but also illuminates the trade-off at the heart of the Budget and the upcoming Spending Review:

increasing spending will require increasing taxation or bending the fiscal rules set out in the Conservative party manifesto.

This trade-off, depicted in Figure 21, is the one that confronts the new Chancellor, and the Prime Minister as they prepare for the Budget.

FIGURE 21: **The Chancellor will have to decide which pair of options he wants to choose – he can't have all three**



Tweaks to the fiscal rules are unlikely to deliver substantial additional fiscal space

With the arrival of a new Chancellor, there has been significant discussion of tweaks to the definition of the fiscal rules to ease the constraints on current spending. There are a range of plausible such adjustments to the rules which could be adopted, however none of them would radically alter the fundamental trade-offs.

First, and most plausibly, the government could push back the three-year deadline over which they have committed to balance current spending. Both the Labour and Liberal Democrat manifestos supported a five-year time horizon. Our estimates suggest that moving to targeting a current balance over five years would allow around an additional £5 billion of spending in 2024-25, relative to reaching a current balance in 2022-23.[27] This is relatively small compared to pressures on spending detailed above and would

27 This is calculated as the change in the OBR's restated March 2019 forecast for baseline borrowing between 2022-23 and 2023-24, rolled forward for an additional year, combined with the expected economic revision to borrowing in 2023-24. Shifting back the date at which the current balance applies means the government would be unconstrained in earlier years.

have no lasting effect on fiscal headroom; you can spend more on teachers, nurses or police today, but the challenge of delivering a current budget balance in 2024-25 will be unchanged.

Second, the government could shift the target to a cyclically adjusted current balance. This would take into account whether there is spare capacity in the economy, and allow additional fiscal stimulus if so. This would be desirable from an economic perspective because it would facilitate a more countercyclical fiscal policy, as we have previously argued.[28] However, as the OBR is likely to forecast the economy at close to capacity over the forecast period, this is unlikely to provide additional fiscal headroom in this Budget. A similar proposal, also justified by allowing greater fiscal stimulus in worsening economic conditions, would be to incorporate a target range for the current balance rule, for example requiring a balance within plus or minus 1 per cent of GDP. While this would create additional fiscal headroom of around £20 billion to the bottom of the target, it would not be credible for the government to immediately aim for the bottom of the target range. Indeed, the relatively benign economic environment would suggest the government should aim for the top end of this range.

Third, the government could try to blur the boundary between additional capital spending, where there is more fiscal flexibility, and current spending, which is seriously constrained. In practice though, this would be hard to achieve; definitions of current and capital spending are judged by the Office for National Statistics and laid out in international accounting rules.

The government could take the much more drastic step of removing the current balance rule entirely, but there would be a significant cost in undermining the credibility of the UK's fiscal framework just three months after it was included in the Conservative manifesto. It would be very unwise to leave the UK operating without a credible fiscal anchor by scrapping a rule with broad cross-party consensus at its first contact with the reality of trade-offs between tax and spend.

To end austerity, the government will need to constrain the cost of tax cuts

So, if the government wants to maintain a responsible fiscal approach and spend more on day-to-day public services, then additional revenue will have to be raised from taxation. At first glance, the government has not made it easy for itself. The Conservative manifesto promised "not to raise the rates of income tax, National Insurance or VAT". This will tie the Chancellor's hands somewhat. But there is much more to tax policy than

28 R Hughes, J Leslie & C Pacitti, Britannia waives the rules?: Lessons from UK and international experience with fiscal rules, Resolution Foundation, October 2019

these rates alone. There are options for targeted tax rises that can be implemented soon, and a strong case for consideration of longer-term reforms. We look at both below.

But just as important as finding was to raise tax is whether the expensive tax-cutting of the Osborne and Hammond years continues. The previous decade repeatedly featured three forms of substantial tax cut:

1. Reductions in the corporation tax rate;
2. Increases in the income tax personal allowance; and,
3. Freezing the fuel duty rate.

A key question is whether similar cuts are made in this parliament. There are already signs that the focus on tax cuts has been toned down in some areas, and there are options to constrain costs elsewhere. Below we explore the three steps that have already been taken, or could be.

Corporation tax cuts have already been cancelled

On corporation tax, we now know that further cuts will not be happening. The rate was scheduled to fall from 19 per cent to 17 per cent in April 2020, but this has been cancelled. This is the largest tax rise in the Conservative manifesto, raising £6 billion a year, as Table 1 shows.

TABLE 1: **The Conservative manifesto included a substantial change in corporation tax policy**

Revenue changes in the 2019 Conservative manifesto, nominal

(£m)	2020-21	2021-22	2022-23	2023-24
Cancel corporation tax cut	3,000	5,200	6,000	6,300
Increase & extend Health Immigration Surcharge	320	530	554	578
Plastic packaging tax	0	0	330	310
Tax avoidance & evasion measures	0	50	150	200
Increase personal NICs threshold to £9,500	-2,170	-2,180	-2,340	-2,500
Raise Employment Allowance from £3,000 to £4,000	-470	-480	-490	-500
Business rates cuts	-320	-10	-10	-10
Increase Structures and Buildings Allowance from 2% to 3%	-130	-205	-260	-315
Increase R&D tax relief from 12% to 13%	-85	-235	-265	-275
Remove VAT from female sanitary products	0	-15	-15	-15
Employer NICs cut for veterans	-20	-25	-25	-25
Total	*100*	*2,600*	*3,600*	*3,700*

SOURCE: The Conservative Party Manifesto 2019, Costings Document

This increased revenue is somewhat offset by a selection of business tax cuts: an increased employer National Insurance allowance; greater corporation tax deductibility for spending on buildings; greater R&D tax relief; and small business rate cuts (with the promise of a fundamental review later). But it is nonetheless a significant revenue source relative to earlier plans, with around £5 billion raised in 2023-24 net of these cuts. There has even been a suggestion that the rate should go back to 21 per cent to fund future business rate cuts.[29]

The fiscal impact of the £12,500 National Insurance threshold ambition must be contained

The manifesto also included a welcome end to the policy of discretionary income tax personal allowance increases (and made no mention of raising the higher-rate threshold). But this has been replaced with a policy of increases in the threshold for National Insurance Contributions.[30] This is a policy better targeted at the stated goal of helping low earners, given that the starting point for personal NICs is currently around £8,600 a year while the personal allowance is now £12,500. But such a policy may still be extremely expensive.

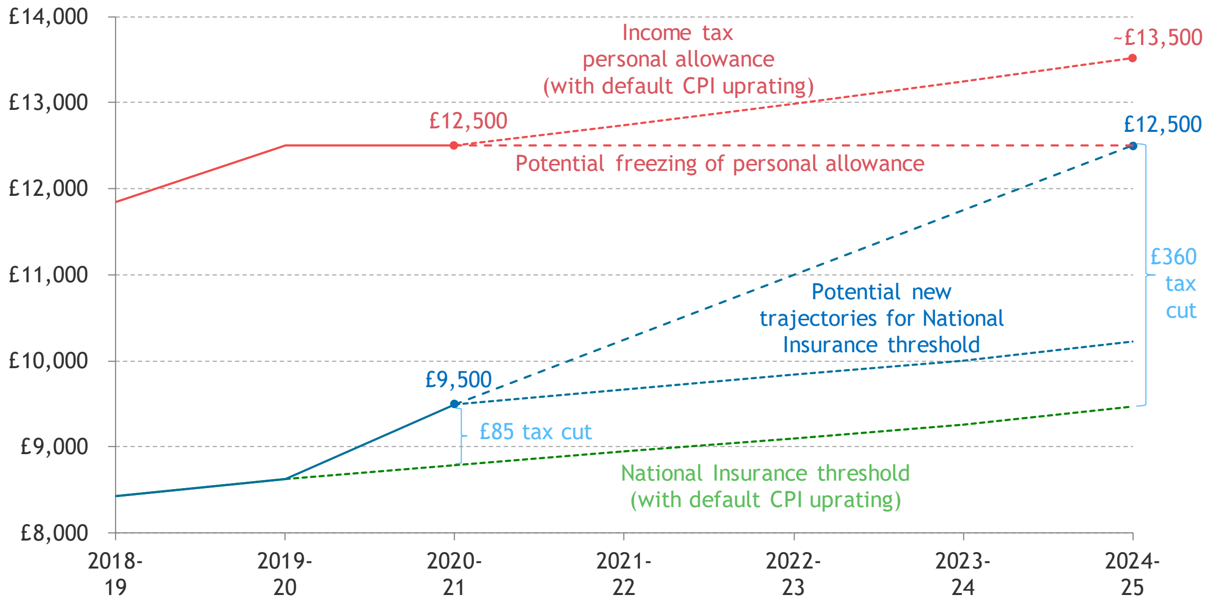
Recognising this, the manifesto promised only a £9,500 threshold – though this will happen very soon, this April – with a heavily anticipated £12,500 threshold being merely the "ultimate ambition". Raising the threshold to £9,500 costs £2.2 billion in 2020-21. But reaching £12,500 by 2024-25 – the latest year possible in this parliament – would cost £8.4 billion in that year, and more if reached earlier. So whether, and how, this ambition is fulfilled is a critical policy choice.

As Figure 22 shows, the future of the income tax personal allowance is also relevant. The manifesto and election campaign made clear that £12,500 is the goal for the NICs threshold. In 2020-21 this would align it with the personal allowance and "ensure that the first £12,500 you earn is completely free of tax". But, on current policy, the personal allowance will rise in line with inflation after 2020-21, to around £13,500 by 2024-25, meaning that £12,500 would no longer align the two thresholds. It could be, therefore, that the personal allowance is frozen (as it has been in 2020-21) to facilitate this alignment and lower the overall cost.

29 Sky News, Hike corporation tax by £6bn to save high street, bosses urge, February 2020
30 Specifically, the threshold for employees and the self-employed, but not for employers. Note that the proposed threshold changes have no impact on future benefit entitlements.

FIGURE 22: **We know that the NICs threshold will rise to £9,500 in April, but where it goes from there is unclear**

Nominal annual tax thresholds



NOTES: Example tax cut figures are for employees rather than the self-employed.
SOURCE: RF analysis using CPI forecasts from OBR, Economic and Fiscal Outlook, March 2019

Freezing the personal allowance for an extra four years while raising the NICs threshold to £12,500 would significantly lower the net cost of this policy in 2024-25 from £8.4 billion to £1.5 billion. And if the starting point for income tax were being frozen, it would be reasonable to also freeze the higher-rate threshold at £50,000 (incidentally, in line with the point at which child benefit begins to be withdrawn). This would further lower the net cost to just £400 million in 2024-25. Of course, as Figure 23 shows, such measures would also reduce the positive impact of the tax cut on household incomes, though they would also make it slightly more progressive.

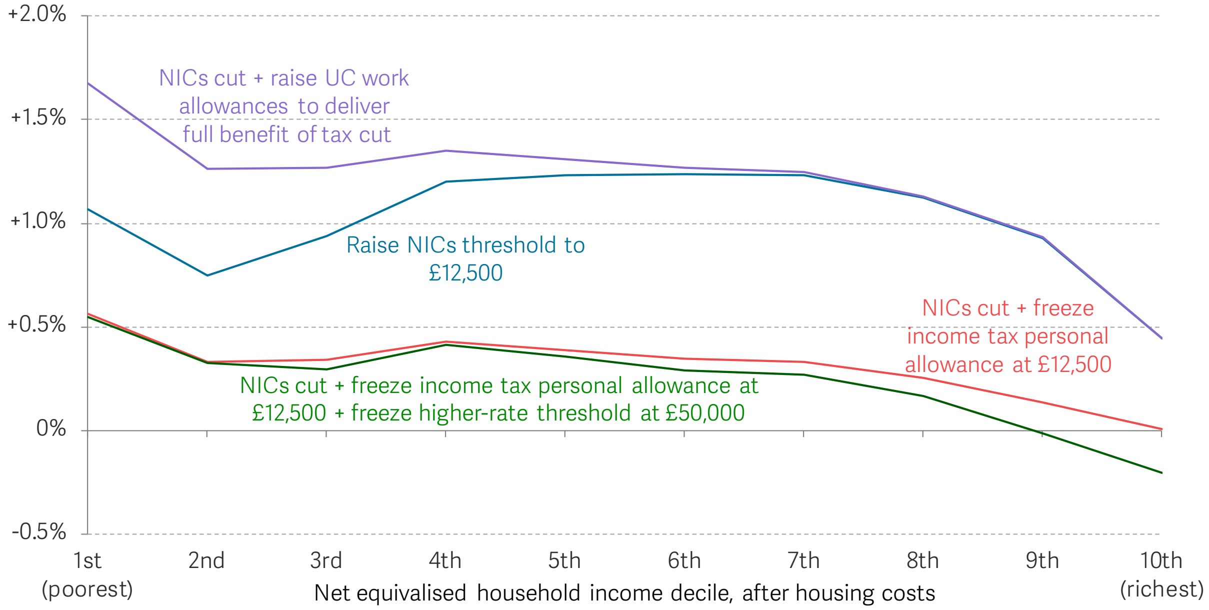
Although there is a need to restrain the cost of this potentially very expensive policy, one welcome improvement would be to ensure that those in lower-income households (on Universal Credit) receive the full benefit. For those in work on Universal Credit, a potential £360 tax cut in 2024-25 would lead to a £230 loss of benefits due to means-testing (driven by the 'taper rate' of 63 per cent), resulting in a net income boost of only £130 a year. This is not a niche issue: for example, the majority of single parents who pay NICs would lose out in this way.[31] To ensure those who need it most receive the full boost, Universal Credit's work allowances would need to be increased by £360 a year (£30 per month) too.[32] Figure 23 shows that this would significantly boost the impact of the tax cut

31 A Corlett, The shifting shape of UK tax: Charting the changing size and shape of the UK tax system, Resolution Foundation, November 2019
32 Alternatively, the reduction in Universal Credit spending as a result of the tax cut could be recycled in other ways to help limit projected child poverty rises.

policy on the poorer half of the income distribution, while costing only around 7 per cent more than the NICs cut in isolation.

FIGURE 23: **Freezing the personal allowance would offset most of the cost (and benefit) of raising the NICs threshold**

Average policy impacts in 2024-25 by household income decile, as a proportion of disposable income: UK



NOTES: The purple line shows the impact of raising the NICs threshold to £12,500 (a tax cut of around £360 a year in 2024-25) as well as an increase of £360 a year in Universal Credit's work allowances.
SOURCE: RF analysis of DWP, Family Resources Survey using the IPPR tax-benefit model

The Budget should avoid repeated fuel duty cuts

In addition to corporation tax cuts and personal allowance increases, the other tax cut favoured under Chancellors Osborne and Hammond was to fuel duty. Relative to pre-2010 plans, the government has cut fuel duty by 29 per cent, at a cost of £11 billion a year.[33]

The default Treasury policy – used in the OBR forecasts – is for fuel duty to rise in line with RPI inflation each year. But such increases have been cancelled repeatedly.

Continuing this freeze over the next four years would cost around £4 billion in 2023-24 (and £9 billion cumulatively over the period as a whole), as shown in Figure 24. Such a tax cut was not included nor costed in the manifesto.

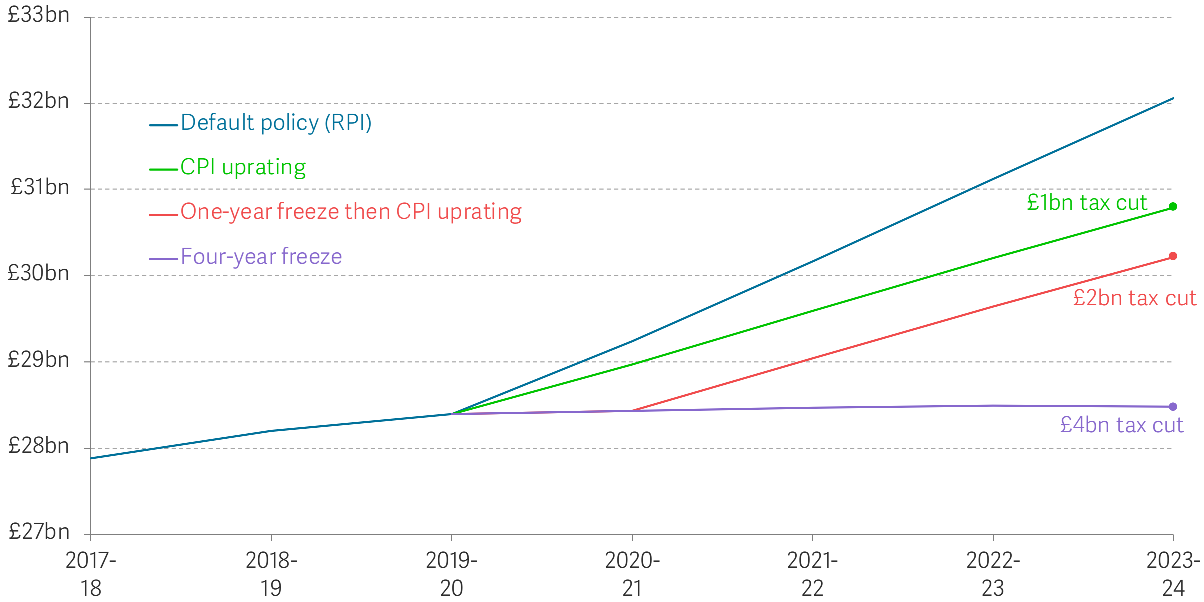
One alternative would be to uprate fuel duty in line with CPI inflation from now on (rather than the higher RPI measure). Relative to the default policy this would be a £1 billion tax cut in 2023-24. Additionally, freezing the rate for 2020-21 only would add around half a

33 S Adam & R Stroud, A road map for motoring taxation, Institute for Fiscal Studies, October 2019

billion pounds a year to the cost. To smooth future fuel duty adjustments, the rate could also be adjusted monthly for inflation, as the IFS have suggested, rather than annually.[34]

FIGURE 24: **A four-year fuel duty freeze would cost £4 billion a year and would not "prioritise the environment"**

Projected fuel duty revenue, nominal: UK



SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, March 2019

The plan for fuel duty over this parliament is particularly germane as the government has promised to "prioritise the environment" in the Budget, following the adoption of the 2050 net zero goal and ahead of hosting the UN Climate Change Conference in November. So a large tax cut for petrol and diesel consumption would be unwise (and added to this is the touted possibility of a cut in Air Passenger Duty for domestic flights). Despite this, the political pressure against the default RPI-uprating policy may be difficult to overcome. But nor is the massive expense of a continued freeze necessary, and a (still expensive) shift to stable CPI uprating would be more sensible. Telling the OBR that government policy is to increase the duty in line with RPI but then cancelling that increase every single year is not good governance nor a good fiscal priority.

There are sensible small ways to increase revenue, including ditching Entrepreneurs' Relief and delivering on environmental commitments

Ending the pattern of cuts to corporation tax, personal income taxes and fuel duty would go a long way to protecting (or at least not worsening) the health of the public

34 Ibid. Note that in this case, any month (e.g. January 2021) could be chosen for the end of the freeze.

finances. But there are a range of other relatively short-term tax changes that should be considered in the Budget. These can be divided into three types:

- Threshold freezes, given the constraints on the main rates of tax;
- Tax changes that help deliver on environmental commitments; and,
- Removing the most obvious inequities in current tax reliefs.

Below we discuss these small revenue-raisers.

Threshold freezes as low-profile revenue raisers

In addition to the potential income tax threshold freezes discussed earlier, other freezes could raise revenue. Freezing the Annual Exempt Amount for Capital Gains Tax at £12,000 for four years would only raise something of the order of £20 million a year,[35] but this allowance is already very generous and allows some to arrange their gains over the long term to pay no tax. The VAT threshold is similarly recognised as being overly generous and distortionary,[36] and has already been frozen for four years. Extending this freeze to 2022-23 and 2023-24 might raise around £150 million a year.[37] Freezing inheritance tax thresholds could raise still more. From April it will be possible for someone to inherit £1 million from their parents tax-free. Maintaining this memorable and generous level to 2023-24, rather than uprating it, would raise around £400 million a year.

Prioritising the environment

Despite the possibility above of fossil fuel tax cuts, as this is a Budget to "prioritise the environment" a net increase in environmental taxes would seem more appropriate. As shown in Table 1, a small plastic packaging tax is planned. Plans to reduce the scale or scope of the £2.4 billion a year 'red diesel' (low fuel duty) discount in future would help.[38] The Climate Change Levy could be increased for commercial fossil fuel consumption, to encourage businesses to use low-carbon heating.[39] And more clarity must soon be given on the future of broader carbon pricing post-Brexit, with the UK likely to leave the EU Emissions Trading Scheme on 1 January 2021.

Vehicle Excise Duty (VED) seems a strong option to help reduce greenhouse gas emissions and air pollution, while also raising revenue. Bringing in around £7 billion a year at present, changes in taxes for more polluting cars could reasonably raise significant

35 Based on HM Revenue and Customs, Direct effects of illustrative tax changes, April 2019
36 Office of Tax Simplification, Value added tax: routes to simplification, November 2017: "there is clear evidence, from academic analysis of HMRC data and from submissions to this review, that the high level of the threshold is having a distortionary impact on business growth and activity".
37 Based on government costings for previous two-year freezes.
38 The government published a call for evidence on the uses of red diesel in 2017, and again in 2018. HM Treasury & Defra, Non-road mobile machinery and red diesel call for evidence: summary of responses, April 2019
39 Budget 2018 announced that the gas rate would rise to 60 per cent of the electricity rate by 2021-22. Movement to equivalise the two could continue in 2022-23 and beyond.

sums. This would help respond to the fact that total surface transport emissions have not fallen at all since 1990, and that the emissions intensity of new cars actually rose in 2017 and 2018 due to growth in SUV sales.[40] And changes in emissions testing procedures, which allow greater detail about each model of car, mean the Treasury has already hinted at more closely linking VED with emissions.[41] While the government intends to end the sale of new petrol or diesel cars from around 2032-35, it can immediately start encouraging new car purchasers – particularly those with high spending power – to buy electric vehicles (or simply cleaner petrol/diesel ones) rather than high-emission cars.[42]

Fixing the most inequitable and leaky parts of the tax system

The commitment not to raise the main rates of tax makes it all the more important to keep the tax base broad and fix elements of the tax system that are particularly ineffective, open to abuse, or both. Below we look at major structural changes to wealth taxes that would help meet spending needs, but smaller targeted changes could also raise significant revenue and reduce arbitrary inequalities in taxation.

Most significantly, the Conservative manifesto proposed to "review and reform Entrepreneurs' Relief", which we have previously described as the UK's worst tax break.[43] There are several reasons why significant reform, or even outright abolition, are needed:

- It is costly: the relief was projected to cost £2.1 billion in 2019-20,[44] and this is likely to grow to over £3 billion a year by 2023-24.[45] For comparison, this is similar to the day-to-day budgets of the intelligence services (£2.8 billion), Foreign and Commonwealth Office (£2.6 billion), Department for Environment, Food and Rural Affairs (£2.2 billion) or Department for Business, Energy and Industrial Strategy (£2.1 billion). And while HS2 has attracted a lot of attention for its estimated price tag of around £84 billion (in 2019 prices), by the time the new railway is completed in 2040, Entrepreneurs' Relief may have a very similar cost over the same period (using rough but reasonable assumptions)
- It is regressive: in 2017-18 there were 43,000 beneficiaries, gaining an average tax cut of £53,000 each, though most of the cost went to an even smaller minority of around 5,000 people with capital gains of over £1 million.
- It often has little to do with innovation: the word entrepreneur conjures up notions of new products, risky investments and rapidly scaling-up firms, but the reality of

40 Committee on Climate Change, Reducing UK emissions 2019: Progress Report to Parliament, July 2019
41 HM Treasury, Review of WLTP and vehicle taxes: summary of responses, July 2019
42 Up-front VED rates should also be considered in parallel with electric vehicle subsidy policies: if the Treasury wants to reduce the £3,500 Plug in Car Grant over time then that is another reason to increase VED for new non-electric cars, to maintain or strengthen purchasing incentives.
43 A Corlett, Entrepreneurs' Relief has cost £22 billion over the past 10 years. Was it worth it?, Resolution Foundation, August 2018
44 HM Revenue and Customs, Estimated cost of tax reliefs, October 2019
45 Office for Budget Responsibility, Supplementary forecast information release: HMRC tax reliefs, November 2018

who gains from Entrepreneurs' Relief can be very different. A popular route is for a single worker (such as a management consultant) to incorporate, retain their earnings rather than taking dividends, and then liquidate the company and extract their money as a relief-eligible capital gain. There is no reason that workers able to manipulate their finances in this way should pay a 10 per cent tax rate (or 27.1 per cent after corporation tax) while other workers pay far more. Indeed, the Treasury should look to clamp down on such income being taxed as capital gains at all (rather than dividend income).[46]

- It is not a good way to help start-ups: even in the case of rapidly growing firms with innovative products, it is not clear that rewarding the greatest successes – rather than helping more succeed – is a good approach. And even without the relief long-term rewards are there for those influenced by such things: the tax rate on capital gains for shares is only 20 per cent.

The Chancellor could easily argue that the substantial cost of Entrepreneurs' Relief would be far better spent on additional R&D, infrastructure, education, or tax cuts for low earners. Short of scrapping it entirely, the options to reduce the cost are to cut the cap on lifetime gains (e.g. from £10 million back to £1 million, cutting the relief's cost in half);[47] raise the tax rate above 10 per cent; change the eligibility criteria to better target it; or a combination of these.

In a similar spirit, there are other tax reliefs that represent significant risks to the tax system or are simply extremely hard to justify. One is the tax treatment of inherited pensions. With the rise of defined contribution pensions, pension pots can be inherited but are not liable for inheritance tax. In addition, where someone dies before the age of 75, their pension pot can be passed on not only free of inheritance tax but also free of income tax, which would normally be paid when money is withdrawn from a pension. This seems unjustified: the reason for pensions' generally favourable tax treatment is to ensure adequate and sustainable incomes in old age: not to provide a vehicle for income to be earned and then passed on to one's children without any tax ever being paid.

Tackling Entrepreneurs' Relief and reliefs on pension inheritances are good policies that should happen regardless of any other Budget changes and requirements. But in addition to these steps, affecting relatively few people, broader reforms to the tax system are needed to make it both fairer and more able to meet any future revenue needs. This Budget may therefore mark the beginning rather than the conclusion of such discussions.

46 'Anti-phoenixing' rules already help prevent some abuse of Members' Voluntary Liquidations, but further reform is needed.
47 T Bell & A Corlett, How wealth taxes can raise billions more without scaring any horses, Resolution Foundation, January 2019

Some parts of the tax system need major reform, but this will be a longer-term process

Aided by the revisions to the fiscal outlook, and the tax options discussed above, the new Chancellor may not see a need to reach for options reported in the media such as flat rate pension tax relief or high-end property tax rises. But given the long-term spending needs of an ageing population and the uncertain economic outlook – and the second Budget coming up later in 2020 – the country should be considering what significant tax changes might be needed in this parliament and beyond. There are options to help maintain a budget surplus, support public services, level-up geographically, encourage growth and even allow targeted tax cuts.

The Conservative manifesto has already promised a "fundamental" review of business rates. But, if anything, this is likely to involve tax cuts: e.g. to help the least prosperous parts of England; to encourage physical investment; and potentially to support green infrastructure (such as exempting solar panels, wind turbines, electric vehicle charging points, green heating options, energy storage, or the electricity grid itself). A review of alcohol duty has also been promised, "to ensure that our tax system is supporting British drink producers".

To *raise* revenue, while also making the tax system simpler and less distortionary, the Chancellor should look at how we tax pensions, inheritances and property.[48] This is particularly relevant to the social care debate and the broader context of an ageing population. Significant new taxpayer money is likely to be necessary, but some of the biggest beneficiaries are likely to be those with significant wealth (and their offspring). This makes the tax-treatment of wealth – which has grown much faster than income in recent decades, while wealth taxes have remained flat – a particularly relevant consideration.[49]

Options in each of these three areas include the following:

- Pensions: There are a range of major pension tax reliefs, with a combined cost of £35 billion a year (net of tax paid on pensions in retirement).[50] This includes the tax-free lump sum, which is particularly regressive and hard to justify. Capping tax-free lumps at £42,000 (rather than an uncapped 25 per cent)[51] would leave three-quarters of drawdowns unaffected while raising over £2 billion a year.[52] Flat-rate income tax relief at 20 per cent could raise up to £9 billion, or allow an increase in

48 Resolution Foundation, A new generational contract: The final report of the Intergenerational Commission, May 2018
49 Ibid.
50 HM Revenue and Customs, Table 6: Registered pension schemes cost of tax relief, September 2019
51 In practice the lifetime allowance provides a form of cap. A lifetime allowance of £1,073,000 in 2020-21 would imply a maximum tax-free lump-sum of around £270,000.
52 Resolution Foundation, A new generational contract: The final report of the Intergenerational Commission, May 2018

the rate for low- and middle-earners from 20 per cent to 28 per cent.[53] In addition, the Lifetime ISA is partly a half-hearted attempt to create a competing approach to pensions, but is both costly and regressive.[54] And there are a range of changes that could be made to the National Insurance treatment of pensions and pensioners.[55] There is ample scope for a new settlement on pension taxation that raises revenue while also focusing support on lower rather than high earners.

- Inheritances:[56] Few people think the UK gets inheritance tax right, with the extremely wealthy paying lower tax rates than the merely very wealthy.[57] There are many policy options to help fix this, including better targeting agricultural and business property relief (which together cost £800 million a year); ending the bizarre (if minor) 'normal expenditure out of income' exemption for the very rich; and ending or restricting the capital gains tax uplift at death. Further options include reforming the treatment of transfers in the seven years before death;[58] taxing all lifetime gifts; revisiting the recently-added, complicated main residence relief; and changes in tax rates. There are difficult trade-offs here – particularly for Conservatives – but also the possibility of an improved tax that commands greater support.
- Property:[59] Council tax is regressive with respect to property value, and (for a given value) is lowest in the richest parts of the country. The combination of these factors means, for example, that a £130,000 Band C two-bed semi in Blackpool pays more in council tax (£1,624) than a £67.5 million nine-bed house in Mayfair (£1,508).[60] As Figure 25 shows, this means that council tax rates are effectively far higher in the North of England than in London.

What's more, by the end of this parliament in 2024, tax bands in England will be based on property values that are a third of a century out of date: valuations made before many properties – and a large proportion of the population – existed. And yet council tax has been rising rapidly to pay for growing social care needs in particular as a result of the social care precept, with the average English Band D charge rising by 4.7 per cent in 2019-20 and 5.0 per cent in 2018-19.[61]

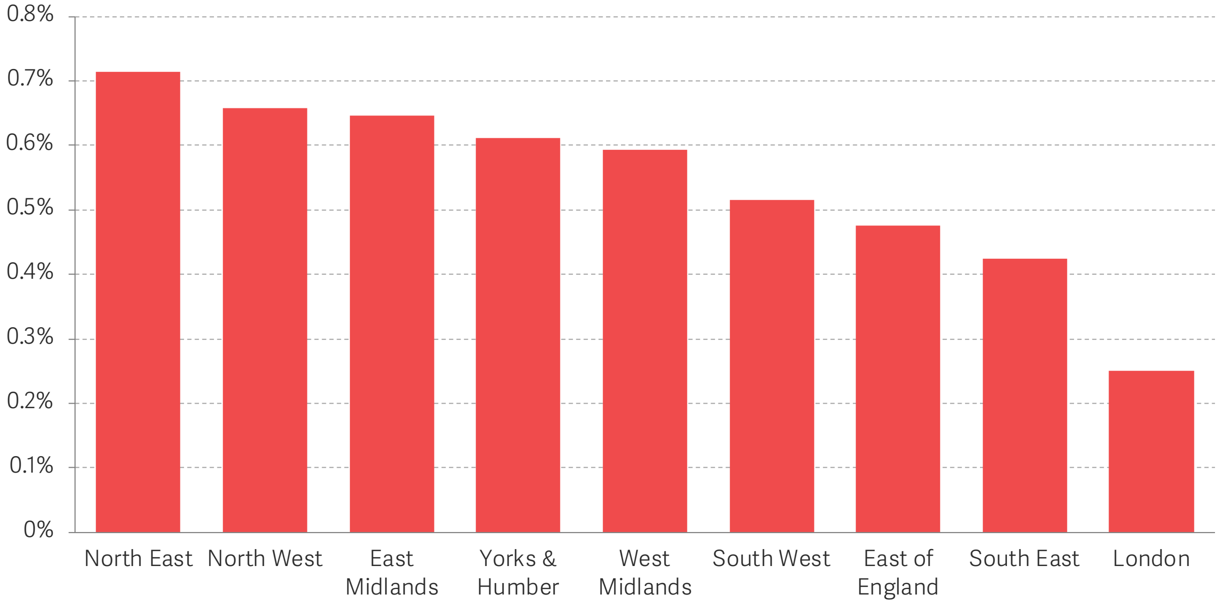
So council tax reform should be part both of the social care funding debate and the levelling-up debate. There are a range of reform options, with wholesale replacement of

53 Ibid.
54 T Bell & A Corlett, How wealth taxes can raise billions more without scaring any horses, Resolution Foundation, January 2019
55 For details, see: Resolution Foundation, A new generational contract: The final report of the Intergenerational Commission, May 2018
56 See: A Corlett, Passing on: Options for reforming inheritance taxation, Resolution Foundation, May 2018
57 Office of Tax Simplification, Inheritance Tax Review – first report, November 2018
58 Office of Tax Simplification, Inheritance Tax Review – second report, July 2019
59 See: A Corlett & L Gardiner, Home affairs: Options for reforming property taxation, Resolution Foundation, March 2018
60 2019-20 council tax figures, and example properties from www.zoopla.co.uk.
61 Ministry of Housing, Communities and Local Government, Council Tax levels set by local authorities in England 2019 to 2020, May 2019

council tax with a proportional or progressive property tax having much to commend it in the longer term. But we have previously shown that even relatively modest changes, such as England copying Scotland's small rate increases for Bands E to H, would raise over £1 billion a year.[62]

FIGURE 25: **Relative to property values, council tax is lowest in London and the South East and highest in the North of England and East Midlands**

Median net council tax as a proportion of property value: England, 2015-16



NOTES: Net council tax refers to council tax less council tax reduction. This analysis covers primary residences only. See: A Corlett & L Gardiner, Home affairs: Options for reforming property taxation, Resolution Foundation, March 2018 for further details.
SOURCE: RF analysis of ISER, Understanding Society

Given the government's large majority, a long parliament ahead, and a strong labour market, in some ways this is a good time to "fix the roof while the sun is shining" (to borrow from a previous Chancellor) and build a tax system that is better able to rise to the challenges of the 2020s.

Conclusion

2019 was a year with no Budget. In contrast, 2020 will be a year of two Budgets, a multi-year spending review and key choices around Brexit. It will set the scene for the entire parliament in terms of spending, taxes and borrowing. It is clear that the government wants to spend more to fulfil its levelling up ambitions and signal a clear break with the austerity era. But to make a significant difference beyond capital spending, the government will need to either bend its fiscal rules or raise taxes, or both. Beyond delays

62 A Corlett & L Gardiner, Home affairs: Options for reforming property taxation, Resolution Foundation, March 2018

that would create little extra headroom, the first approach would present a threat to Britain's economic credibility. Focusing on boosting tax revenues is far more sensible. So the question for 2020 is whether the Conservatives, having given up being a small state party, are content to also say goodbye to being low tax.

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