New Chancellor. BIG Budget

Spring Budget 2020 response
Summary

Britain’s new Chancellor gave the country a big Budget, combining a larger-than-expected response to coronavirus with a resetting of the Government and Conservative party’s approach to managing the public finances. A large appetite for increasing public spending has been combined with far less appetite to raise taxes. The result is a Conservative Chancellor now planning a bigger state than was seen under Tony Blair, financed through higher borrowing than Gordon Brown oversaw as Chancellor. The new Conservatism is certainly far from fiscally conservative.

Economy

These big decisions were taken against a poor economic outlook. In fact, the Office for Budget Responsibility’s (OBR’s) economic forecast managed to be incredibly grim, while also being far too optimistic. Its forecasts (which took little account of coronavirus) suggest that growth will average just 1.4 per cent a year, well below even the 1.9 per cent average growth in the disastrously slow-growing, post-crisis decade we have just lived through. But the most recent OBR forecasts were completed long before the widespread domestic impact of coronavirus was clear and included the idea that the British economy would grow by 1.1 per cent this year and 1.8 per cent next year. In stark contrast, last week’s Organisation for Economic Co-operation and Development (OECD) forecasts suggested that the UK economy will grow at 0.8 per cent in both those years. Replacing the OBR’s pre-pandemic forecasts for this year and next with the OECD’s more recent forecast would bring the UK’s annual growth outlook down to an average of just 1.2 per cent – the worst average annual growth forecast on record.

Without these coronavirus impacts, the OBR has pay growth weakening in every year of the forecast. The history of the past decade has shown that weak growth can be a painful brake on living standards. The economic hit from weaker growth even on these forecasts is around £300 per household this year, rising to almost £600 per year by the middle of the Parliament.

Coronavirus

To reduce the size of the highly uncertain economic impact from coronavirus, the Government provided a major and welcome £12 billion response package. This was delivered in coordination with the Bank of England’s decision to cut interest rates and increase the potential and incentives for banks to lend.

Beyond the top priority of increasing funding for the NHS by £5 billion, the focus of Government action was on supporting households and particularly firms, with a plethora of announcements in this space. There was £5 billion of support for firms, with the aim of
preventing a temporary shock becoming permanent if otherwise viable companies close or lay off workers. Bigger-than-expected measures to allow small and medium-sized firms to reclaim the costs of coronavirus-related sick pay were combined with direct grants to small businesses of £3,000 and an 80 per cent state guarantee for loans.

While firms were the focus, much less (£1 billion) by way of direct support to families affected was put in place. There was welcome action to make entitlement to contributory Employment and Support Allowance (ESA) immediate upon falling ill, which will particularly help the self-employed. However, the Government failed to extend Statutory Sick Pay (SSP) to 2 million low earners, leaving them reliant on less generous Universal Credit (UC) with its waits and means tests. The government also chose not to follow the example of Ireland to increase the rate of sick pay, despite the UK’s very low level. A typical worker who is entitled to SSP (worth £94.25 a week) would still lose over two-thirds of their normal pay when off sick or self-isolating.

When combined with wider spending increases of £18 billion, this action on coronavirus implies a fiscal stimulus in 2020-21 of £30 billion or 1.3 per cent of GDP. The UK’s swift combination of monetary and fiscal stimulus stands out compared to the central bank going it alone in the US and only individual Eurozone countries offering fiscal responses to date, with no action from the European Central Bank. But the measures taken to support the economy so far may prove insufficient in the event of a major virus outbreak in the UK. If so, the Chancellor will need to be ready to provide more fiscal support, because monetary policy is close to its limits with policy rates close to zero and long-term interest rates at all-time lows.

**Spending**

While the coronavirus response was bigger than many expected, it was dwarfed by wider increases in public spending across the whole of this Parliament. Overall, the Chancellor chose to increase spending by a total of £203 billion over the next five years, decisively ending the era of austerity, with big increases in both day-to-day public service (current) and investment (capital) spending.

Crucially, these increases provide the framework for the Spending Review due later this year. At that event the Chancellor will allocate to individual departments the overall spending totals set out in this Budget through to the expected date of the next election. Taken together these totals imply that, while austerity will not only ended but been put into reverse on the capital side, all will not be plain sailing for day-to-day public services over the next few years. In both areas, big trade-offs will still need to be made.

An additional £100 billion of capital spending to meet the Conservative manifesto commitment to increase public sector net investment to 3 per cent of GDP sets the UK
on course for the highest sustained levels of such spending in 40 years. This is sufficient to reverse all of the cuts to capital spending since 2010 (although not the lasting effect of those cuts on our capital stocks). While most (57 per cent) of the additional spending has not yet been allocated, of that that has been allocated, funding for research and development accounts for over a quarter, transport 8 per cent and social infrastructure just under a third.

While successive Chancellors have been increasing capital spending since 2016-17, bringing austerity to a close on current spending is a recent phenomenon. Rishi Sunak built on the significant increase in such spending for next year announced in September 2019, with a £142 billion total increase over the next five years, compared to plans in March 2019. The Spending Review later this year will therefore apportion day-to-day spending that is growing by an average of 2.8 per cent a year. This is well above the rates of the past decade, but a significant slowdown from the 4.1 per cent announced for the coming financial year back in September, and below the growth rates that prevailed throughout most of the 2000s.

This spending increase will return overall real-terms day-to-day public service spending (RDEL) per capita to 2009-10 levels in 2024-25. However, austerity will continue for many departments, with spending increases only sufficient to reverse around a quarter of the real cuts per capita to unprotected ones (outside health, defence and international development) since 2010. The Department of Health and Social Care will have spending in 2024-25 that is up by over a quarter (26 per cent) compared with 2009-10 levels, but the Department for Transport could still be set to operate with spending cut by a half since 2010, while the Justice Department could be down by a quarter.

Despite these very significant increases in spending, the Budget does almost nothing to offset the considerable welfare cuts put in place by George Osborne in 2015. Households in the second net income decile, for example, will eventually be £2,900 a year worse off (on average) thanks to benefit and tax changes announced since 2015, with £900 of that yet to come as a result of welfare policies still being rolled out. These cuts mean the incomes of the poorest families have actually fallen over the past two years, and there is a risk that child poverty will reach record highs by the time of the 2024 election.

Tax

Compared to the increases in spending, there were only modest rises in taxation (£8.5 billion in 2024-25, or £32 billion over the next five years). These increases were largely achieved by deciding not to go ahead with further cuts to Corporation Tax, with a major contribution also being made by the very welcome decision to reduce the maximum gain
from Entrepreneurs’ Relief from £1 million to £100,000. What we have previously called the “UK’s worst tax relief” is still far from perfect, but it is now at least much smaller.

These tax rises were partially offset by smaller tax cuts. Delivering on the manifesto promise to raise the employee National Insurance threshold will deliver a small tax cut of up to £85 a year for around 30 million workers, though low-income households on Universal Credit will receive only £32 of that. In addition, the Fuel Duty and Alcohol Duty freezes, and small changes to VAT, will save the average household around £30 a year. Many higher earners were also taken out of controversial measures to limit their tax-relieved pension saving.

Taken together, these add up to small boosts to household finances across the income distribution, but with some very high earners receiving a large tax cut and others a large rise.

Although reviews of Business Rates and Vehicle Excise Duty were promised, the Chancellor ducked more difficult issues around the taxation of pensions, property and inheritance taxes. It is also not clear if Fuel Duty will ever rise in line with inflation, nor when the National Insurance threshold will reach the £12,500 promised in the Conservative manifesto.

Fiscal/borrowing

Without big increases in taxation, the Chancellor has significantly increased borrowing to make the spending increases happen, marking a seismic shift in the Government’s approach to the public finances.

In less than five years, the Government’s ambition has gone from shrinking the state in order to run an absolute budget surplus, to growing public spending to almost 41 per cent of GDP and actively aiming to borrow around £60 billion in each year. That represents a higher deficit as a share of GDP than Gordon Brown averaged as Chancellor, a period during which some have argued that more fixing of the fiscal ‘roof’ might have been in order.

Despite some (but not our) expectations, the Chancellor was able to say that he is still projected to meet the fiscal rules set out only three months ago in the Conservative manifesto, with £12 billion of headroom against the key fiscal target of a current budget balance in 2022-23. But while he may be projected to be meeting the rules, and while they have played an important role in terms of constraining the Spending Review envelope, the Chancellor is clearly far from attached to them. Their spirit is certainly not a guiding light for government policy. That is clear from the decision to keep very little headroom against the current budget balance target despite the huge economic uncertainty that
presently exists, and more substantively from the fact that the goal of debt falling over
time has also been jettisoned in practice. While the need to bring debt down has been a
lodestar of economic policy over the past decade, debt as a share of GDP is now forecast
to be flat – rather than falling – from 2021-22 onwards. Unless you believe another
recession is never likely to occur (a bold view in the current circumstances) then this is in
fact a recipe for debt to rise over time, as recessions ratchet it up. Understandably given
the scale of this change in approach, the Chancellor announced a welcome review of the
fiscal framework. This should include a wider move to target the Government’s overall
balance sheet, focusing on what the state buys with its capital spending, not just on what
it spends. But it should not lead to the removal of all fiscal anchors, nor an abandonment
of the idea that in the end day-to-day public service spending should be financed from
taxation rather than borrowing.

Conclusion

This Budget reflects a busy combination of a major response to the very real crisis of
today with the Government’s goal to be seen to turn the corner on the austerity decade
of the 2010s. On the former, an impressively broad package was set out, albeit with too
little focus on helping individuals navigate the worrying months ahead. On the latter, the
Government’s objective is now to increase spending as much as possible without losing
control of the public finances, rather than to see borrowing fall, and to be prepared to
cut spending to make that happen. Such an approach has significant merits given much
lower borrowing costs and the very significant needs for public spending both to meet
the country’s infrastructure needs and deliver the improvements in public services that
the public wants to see.

But the Chancellor’s approach is not without risks. On public services and social security
respectively, it may not feel like austerity has ended, with the majority of cuts to many
departments remaining in place and child poverty still on the rise. On taxation, the
opportunity to begin the process of badly needed reforms to the UK’s wealth related
taxes has been passed up. Partly as a result, Rishi Sunak has set the country on course
not just for higher borrowing but higher debt, without much sense of where that might
end up. The Chancellor has rightly won many plaudits for his Budget debut, and in
particular for the coronavirus response which stands in stark contrast to the inadequacy
on display overnight from Donald Trump. But there aren’t many easier Budgets than
those that dole out lots of cash and don’t ask anyone to really pay for it. Tougher times lie
ahead.
The economic outlook is bleak, even without taking coronavirus into account

The economic outlook is normally the centrepiece to the OBR forecast, but this time it has been overtaken by events, and more specifically coronavirus, before even being published. The result is that the OBR’s economic forecast managed to be incredibly grim (particularly on the UK’s long-run growth prospects) while also being far too optimistic (on likely growth this year).

Even absent an impact from coronavirus, the OBR has reduced its expectations for real GDP growth significantly. In 2020, the growth forecast is down by 0.4 percentage points relative to the OBR’s March 2019 estimate. This leaves the economy £8.6 billion smaller in 2020 than the OBR anticipated a year ago, equivalent to a loss of £310 per household. This short-term downgrade is less than expected, not least because of additional spending announced by the Chancellor that provides a considerable fiscal boost this year (increasing GDP by 0.3 percentage points by end of the year), and leaves the OBR taking a more positive stance than the Bank of England did in January 2020 (although similar to the HM Treasury panel – see Figure 1).

FIGURE 1: The OBR has downgraded the short-term outlook for growth

2020 calendar year forecasts for real GDP growth

NOTES: Unless otherwise stated, all figures in this report refer to the UK.

In contrast to this near-term relative optimism, the OBR’s medium-term outlook is dismal. Figure 2 shows cumulative real GDP growth over the five-year forecast period for each...
fiscal event since the OBR’s inception. As it makes plain, the OBR’s outlook in March 2020 is the second-weakest in its history, pipped only by its March 2018 prognosis. If yesterday’s forecast holds true, we estimate that the economy will have under-performed by almost one-quarter relative to the average five-year growth rate of the preceding decade. And the growth rates for the fourth and fifth years of the forecast are both the weakest on record.

FIGURE 2: In the medium term, growth looks set to be very weak
Cumulative growth in real GDP levels over five-year forecast period, by fiscal event

Underpinning the OBR’s medium-term forecast is further pessimism on productivity growth. In Figure 3 we show the key factors driving the OBR’s growth forecasts to 2023 and the sheer size of the markdown to productivity. However, the OBR indicates that productivity is forecast to remain at a low level not just because business investment remains depressed, but also because of Brexit-related effects. Basing its latest forecast on the assumption that total net migration falls to 129,000 and the UK moves in an orderly fashion to a new trading arrangement, it assumes that the eventual impact of Brexit is that potential productivity will eventually be around 4 per cent lower than it would have been. It further estimates that about a third of this hit has already affected the UK, about a third is seen in the current forecast period, and about a third happens beyond 2025.
The poor productivity outlook is driving down expectations for growth

Contributions to the change in the OBR forecast for non-oil GVA between March 2019 and March 2020

NOTES: The OBR output gap is for non-oil GVA, so totals will not correspond to the GDP forecast; revisions to non-oil GVA prior to 2018 Q4 have been excluded; due to changes to the OBR publication the starting point for potential output has had to be inferred from data on the output gap and changes to non-oil GVA.

SOURCE: OBR, Economic and Fiscal Outlook, various.

Pushing in the opposite direction is the impact of spending measures announced in today’s Budget. The dark blue bars in Figure 3 give a sense of the scale of the impact, with the contribution from the fiscal loosening contained in the Budget building to 0.5 per cent in early 2022. This then shrinks, in part because the OBR assumes the Bank of England will need to set tighter monetary policy than otherwise in response, given limited spare capacity.\(^1\) On the supply side, the impact of weak productivity is partially offset by further good news on the labour market.

While the impact of coronavirus is highly uncertain, it will lead to a weakening in the economic outlook

The OBR forecast contains almost no impact from coronavirus. This is because – following standard conventions for its forecasting process – the OBR closed its forecast to new data well in advance of publication (14 February). This is both understandable, and deeply suboptimal. At that point, the effects of the virus were confined to mainland

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\(^1\) It is also noteworthy that the OBR has not revised up its forecast of productivity growth despite the Government’s plans to increase investment substantially, arguing that any impact would be felt outside the forecast window (it thinks the investment announced for this forecast window could eventually boost productivity by 0.5 per cent, although the Chancellor was keener to repeat the OBR’s assessment that if government investment as a share of GDP remained high indefinitely, then this could boost productivity by around 2.5 per cent).
China. And while the OBR marked down its global forecast to incorporate an estimate of the economic disruption in China, this only has a small effect on the UK, reducing GDP by just 0.1 per cent.

But since the OBR closed its forecast there is mounting evidence that the economic impact of the virus will be much larger that currently incorporated. Most obviously there has been contagion beyond China, including to some of the UK’s largest trading partners in Europe. In addition, there have been large falls in risky asset prices. For example, the FTSE-100 equity index is down just over 20 per cent since the forecast was closed, including the largest single-day fall since the financial crisis (on 9 March), and oil prices have fallen by around 35 per cent. Even though other factors may have exacerbated the extent of asset price falls, they illustrate a high level of concern about the likely impact of coronavirus.

The eventual impact of coronavirus on our economy is obviously extremely uncertain and will depend, ultimately, on the extent to which the virus spreads. But what we have seen so far suggests the impact of coronavirus could be large. Falls in asset prices to date will lead to a tightening in financial conditions. This means that it will be more expensive for business to borrow. In addition, uncertainty has increased significantly. As Figure 4 shows, measures of uncertainty available at a high frequency (predominantly from financial markets) have increased to levels not witnessed since the financial crisis. While these measures may exaggerate the lasting rise in economic uncertainty, it is likely that, alongside the need to respond individually and collectively to the virus, they will significantly weigh on spending by households and firms.

The range of estimates for the eventual impact is large, but the impact could be severe if the number of UK coronavirus cases increases substantially. Based on the effects seen so far, the OECD suggested that the UK economy will grow at 0.8 per cent over the next two years.\(^2\) Replacing the OBR’s pre-pandemic forecasts for this year (1.1 per cent) and next (1.8 per cent) with the OECD’s more recent forecast would bring the UK’s annual growth outlook down to an average of just 1.2 per cent – the worst average annual growth forecast on record (with data going back to 1985). In the same vein, the National Institute for Economic and Social Research points to a GDP loss of 0.5 per cent this year if the spread of the virus is relatively limited.\(^3\) These relatively modest estimates based on optimistic assumptions about the extent of the spread of the virus pale by comparison to estimates of the effect of a full-blown epidemic. Simon Wren-Lewis finds, in a much more severe scenario, that GDP could eventually fall by as much as 6 per cent.\(^4\)

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The inevitable markdown for the coronavirus will compound the weakness in the OBR forecast. If the inevitable coronavirus downgrade to the real GDP forecasts was just 0.2 per cent over the next five years, this would result in the OBR’s five-year expectation for growth coming in below any previous official five-year forecast (at 7.1 per cent). Such a prospect is not improbable: the Chancellor himself pointed to the likelihood of “a significant impact on the UK economy” in his Budget speech yesterday.

Given all this, it is not surprising the risk of recession has increased. Figure 5 shows a simple measure of recession risk which uses regression methods to map from financial market indicators to the probability of a recession. That probability has now risen to its highest level since the start of 2008, just prior to the financial crisis.

Taken together, all this suggests that coronavirus will lead to a deterioration in the economic outlook.

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5 For more details, see: J Smith, Failing to plan = planning to fail, Resolution Foundation, July 2019.
Despite weakening growth, the outlook for pay and incomes has improved in the near term

Perhaps surprisingly, given the broader picture of slowing GDP growth, the OBR’s outlook for the labour market has improved from the position a year ago (except in 2023-24). We are used to this being the case on employment, as it has exceeded expectations year on year. Much more unusually, the OBR also became more optimistic on pay in this forecast. This is good news for workers and families, but also for the public finances. And as with GDP, it is worth focusing on the longer-term elements of the forecast, given that the near-term forecasts do not reflect the potentially very large impact of the coronavirus outbreak.

High (and higher-than-expected) employment is a striking feature of the UK’s labour market. At the end of 2019, the 16+ employment rate (the measure the OBR uses) reached 61.7 per cent. This is some way above the OBR’s 2016 forecast of 60.0 per cent, a reasonable view at the time given the employment rate was already as high as the pre-crisis high point. Since then, employment has continued to surprise on the upside, and, as Figure 6 shows, the OBR has once again marked up its employment forecast. The result is that, although the 16+ employment rate is now expected to fall back slightly to
61.4 per cent at the end of 2020, this is still 0.3 percentage points higher than forecast this time last year. The OBR’s mark-up on labour supply extends to hours worked as well as employment: average hours per worker were slightly higher in 2019 than the OBR expected. In reality, both these forecasts will be among those most affected by the impact of coronavirus on the ability of workers to work.

FIGURE 6: The employment outlook has continued to improve over the past year

The broad picture is the same for unemployment, with unemployment coming in lower than the OBR forecast a year ago. However, unlike employment, here the medium-term outlook has actually slightly deteriorated. The OBR now takes the view that unemployment will settle at 3.8 per cent for the next two years before rising to 4.1 per cent by 2024, higher than the 4.0 per cent forecast last year.

Despite the broader economic slowdown, the tightening labour market has boosted pay packets, with average weekly earnings finally returning to their pre-crisis peak in December. In line with its revisions to the employment forecast, the OBR has marked up its expectations for pay growth, although only in the near term. As Figure 7 shows, real growth in employee earnings in 2020 is now expected to be 1.9 per cent, compared to just 1.1 per cent forecast a year ago (although the impact of coronavirus may make the old

See: N Cominetti, A record-breaking labour market – but not all records are welcome, Resolution Foundation, February 2020.
forecast best suited to early 2020 only). The outlook for 2021 and 2022 is also improved. But the outlook for 2023 and 2024 has worsened, driven by the OBR’s more pessimistic view on long-term productivity growth.

FIGURE 7: Earnings are expected to remain resilient in the short term, but to weaken significantly in the years ahead

Average annual growth in real (CPI-adjusted) employee earnings, outturn and successive OBR projections

Still, the stronger near-term outlook is welcome, and if it proves accurate then it will mean a significant improvement in pay packets. As Figure 8 shows, the OBR now expects the average employee to be over £400 per year better off by 2024 compared with its view a year ago.
Beyond the tight labour market, the other factor having a big impact on pay is the National Living Wage (NLW). Box 1 discusses the Government’s ambitions for the path of the minimum wage in the coming years, as set out in the Budget.

**BOX 1: The future path of the National Living Wage**

Since its introduction in 2016, the National Living Wage (NLW) – the legal minimum hourly wage for workers aged 25 and above – has been set based on a target relative to median hourly pay. The Chancellor confirmed that the new target for the NLW will be to hit two-thirds of median hourly pay by 2024, significantly above the current target of 60 per cent which will be achieved next month when the NLW rises to £8.72. The other policy change is to extend the NLW to 21-24 year olds by 2024 (with the target based on the median pay of the age group covered by the policy).

Figure 9, which shows the difference between the OBR’s current and previous forecasts, also shows the impact of raising the NLW target. The OBR now expects the NLW will be £10.30 in 2023 and £10.69 in 2024 in cash terms. Last year the NLW was forecast to be £9.59 in 2023, 71p lower. The new policy means the NLW will rise somewhat slower in nominal terms than in the recent period: the average annual increase was 6.1 per cent from 2015-20, compared to a projected 5.2 per cent from 2020-24.
The OBR has also updated its analysis of the potential employment effects of the higher NLW. It estimates that raising the NLW will increase unemployment by 50,000 in 2024, and the unemployment rate by 0.1 percentage points, compared to sticking with the previous policy of targeting 60 per cent of median pay. They also believe the higher NLW will reduce firm profits and lift consumer spending, and will affect associated tax receipts.

These effects are based on the OBR’s assumption that firms react to the NLW by reducing their demand for labour. This is interesting because the empirical literature on minimum wages tends to disagree. Last year’s Dube review, commissioned by the Government to look at the case for raising the NLW, concluded that ‘overall the most up to date body of research from US, UK and other developed countries points to a very muted effect of minimum wages on employment … even for the most recent ambitious policies’. 7 This is typically attributed to the fact that employers have power over workers which means that, absent a legal wage floor, employers pay less than the market would otherwise bear.

The OBR acknowledges this tension, and this year assumes a weaker employment effect (it uses a labour-demand elasticity of 0.3 instead of 0.4). But it still assumes the NLW is reducing employment. It argues, reasonably, that existing evidence is of limited use,

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given those studies have not looked at minimum wages as high as the NLW. Indeed it suggests that the effects can be expected to strengthen with sectors now affected by the NLW more subject to ‘conventional market pressures’, implying less wage-setting power on the part of employers and fewer ‘rents’ to erode.

Whether or not the OBR is right about the size of current and future effects, no one doubts that at some level a minimum wage would have negative effects on employment. Therefore, as we have argued before, the best conclusion to draw from the OBR’s assumptions is that we should proceed with future rises with caution, and be capable of rowing back quickly should employment effects materialise.8

What does the better than expected labour market outlook mean for household incomes? With both employment and pay marked up in the near term, household incomes have come in half way between the OBR’s pre-referendum forecast in 2016, and their much more pessimistic projections in the year after the referendum. As Figure 10 shows, at the end of 2021, average disposable income per capita is now expected to be £21,310, 0.7 per cent higher than forecast this time last year but very dependent on how the next few months play out. Looking further ahead, the outlook is less positive. Average disposable income growth is set to slow as employment gains cease and pay growth slows, resulting in incomes at the start of 2024 expected to be exactly the same as forecast this time last year. This reinforces the lesson of the last few years that productivity growth matters for family living standards.

The short-term outlook for firms’ profits has deteriorated

Normally we would expect trends in broader economic growth and developments in the labour market to go hand-in-hand. So bad news on GDP and good (short-term) news on the labour market presents a puzzle. How can it be resolved? The answer appears to lie in a higher portion of national income going to workers, with the OBR expecting lower firm profits in the near future before they recover as wage growth slows. As Figure 11 shows, the OBR expects non-oil private non-financial corporation profits to be lower in the coming years than forecast this time last year.
Rather than economic changes, the government’s big decision to spend more dominates the public finance forecast

The Government will now borrow substantially more over this Parliament than was expected in the March 2019 Spring Statement: £108 billion over the next five years. But despite the downgrades to the economic outlook, the impact of revisions to the fiscal forecast from the OBR’s assessment of economic prospects was small. While the pessimistic assessment of productivity growth (discussed earlier) reduces future tax receipts and raises spending commitments, this was mostly offset by lower interest rates, reducing government borrowing costs.

Instead, higher borrowing was driven by policy changes. Part of this will fund a package of measures to tackle the social and economic fallout from the spread of the coronavirus, but it is mainly driven by material increases in government investment and day-to-day public service spending.

Figure 12 gives a breakdown of the additional £46 billion of borrowing in 2020-21, by the source of changes. The direct response to coronavirus, which provides additional resources for the health response as well as measures to reduce the economic effects, is set to cost around £12 billion, although this costing must be especially uncertain as it depends on the extent of the spread of the coronavirus in the UK.
Non-virus-related spending increases are bigger, increasing government borrowing by a little short of £20 billion in the coming fiscal year (with 85 per cent of the increase in departmental spending in that year, and almost 90 per cent of the investment spending, having been set out in the 2019 Spending Round). There have also been material statistical revisions since the last OBR forecast – mostly as a result of the accounting treatment for student loans – which push up borrowing by a further £19 billion.

FOR FIGURE 12: Borrowing forecasts for the coming financial year have risen dramatically

Change in the OBR forecast for public sector net borrowing, by source of revision: 2020-21

Looking further ahead, the changes in government spending on departments and investment is even more sizeable (see Figure 13). Day-to-day departmental spending in 2023-24 is set to be £32 billion higher than was expected a year ago, and investment £14 billion higher. Partially offsetting these spending increases, the Budget included small net increases in taxes which amount to an additional £9 billion of revenue by 2023-24. There are also downward revisions to borrowing, reflecting the end of contributions to the EU Budget. Additionally, the OBR has accounted for the sizeable macromacroeconomic effects of the fiscal stimulus feeding back into improved government receipts and reduced spending: these second-round effects are expected to reduce borrowing by £8 billion a year by 2023-24.
FIGURE 13: Borrowing forecasts for 2023-24 have risen even further

Change in the OBR forecast for public sector net borrowing, by source of revision: 2023-24

NOTES: Other changes include: adjustments for direct fiscal gains from Brexit, second-round macroeconomic effects of the fiscal boost on the economy and a new migration regime, and other spending measures (including those not on the Budget scorecard).
SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, various.

Importantly, though, none of these borrowing figures capture the almost-certain deterioration in global economic growth as the coronavirus pandemic continues. Had this been included, the fiscal picture would surely have been more negative (i.e. borrowing even higher), even if partly offset by the fall in gilt yields.

Even on the basis of the OBR’s forecasts that mostly ignore the coronavirus pandemic, the increase in the forecast for public sector net borrowing (PSNB) is the largest since the financial crisis. Figure 14 demonstrates that the scale of the new policy measures announced by the Chancellor is unprecedented over the past decade of fiscal events.
FIGURE 14: Government policy changes are larger than any point since the financial crisis

Nominal change in cumulative five-year public sector net borrowing in successive OBR forecasts

Higher borrowing

Government measures

Forecast revisions

Overall change in PSNB

Lower borrowing

NOTES: Cumulative PSNB is calculated over the maximum forecast horizon provided by the OBR. Forecast figures include indirect effects of Government decisions, and forecast revisions include changes resulting from statistical revisions and economic revisions.

SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, various; HMT, Budget documents, various.

To take a longer-term view, we can estimate the size of the policy changes by looking at the shifts in the cyclically adjusted primary balance since the mid 1970s (this provides an estimate of the change in government borrowing abstracting, albeit imperfectly, from moves in the economy and the level of interest rates). Figure 15 shows that the fiscal loosening is large relative to the most recent history, but much smaller than fiscal responses to the financial crisis and the early 1990s recession – and smaller than the sustained increases in public spending during the early 2000s.
The OBR’s forecast for PSNB as a share of GDP leaves it well below the levels reached during the financial crisis and its immediate aftermath. However, while borrowing in every year of the forecast is expected to be above the average level seen while Gordon Brown was Chancellor, it will rise above the post-war average of 2.5 per cent only in the first two years.

Following pledges in the Conservative party’s 2019 election manifesto, the Government was expected to outline a new set of fiscal rules in this Budget. However, the Chancellor instead announced a review of the fiscal framework to ensure that any rules adopted reflect the macroeconomic environment and facilitate the Government’s economic agenda (we return to our view of the best approach the Government can take in setting fiscal rules later in this report). But, despite not officially adopting the rules set out in the manifesto, the Treasury has pointed out that its Budget decisions mean that the Government is projected to meet them. It is therefore helpful to consider how the Budget performs against the fiscal rules proposed by the Conservative Party during the election.
FIGURE 16: Borrowing is expected to remain well below previous peaks

Public sector net borrowing as a proportion of GDP, outturn and successive OBR projections

NOTES: Post-war net average borrowing refers to 1948-2018. 2020-21 includes the £12 billion policy package for coronavirus.
SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, various.

The most constraining rule is to target a positive current balance by the third year of the forecast, or 2022-23 for this Budget. This means that day-to-day spending and depreciation should be covered by government revenue, rather than financed through borrowing. On the OBR’s forecast the Government is currently on track to meet this target in every year of the forecast (except 2020-21: this reflects the one-off spending measures to tackle coronavirus).
However, as Figure 18 shows, the level of priority attached to this rule being met is low, with the amount of headroom the Government has against it being the second lowest forecast since 2010 (considered across the fiscal rules in place at the time). The £12 billion of headroom represents just 40 per cent of the average upward revision in the OBR’s borrowing forecast over three years.

Beyond some explicit fiscal rules, the Conservative party’s 2019 election manifesto included an aspiration to have debt fall as a share of the economy over the life of this Parliament. This continued the post-2010 trend of Conservative chancellors seeking to bring public debt down. This aspiration is forecast to be achieved, but only due to the forecast withdrawal of loans made by the Bank of England as part of their Term Funding Scheme (TFS), which count towards the stock of government debt.
FIGURE 18: The Government is very close to breaking the current balance rule
Headroom of fiscal rules at introduction, and average borrowing forecast errors

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.

As Figure 19 shows, without this change, debt as a share of income is expected to rise over the next five years. And, just a few hours before the Budget, the Bank of England announced a new TFS programme which could “provide in excess of £100 billion in term funding”. This new round of loans would also appear in public sector net debt (PSND), making it unlikely that the Government will achieve lower debt at the end of the Parliament. These large moves in PSND resulting from Bank of England policy actions highlight that headline changes in government debt are a bad metric for considering fiscal sustainability, and should not be included in any future set of fiscal rules. Even with the impact of the TFS included, debt is broadly set to be flat from 2021-22 onwards, reflecting an abandonment of the objective of falling debt.
The Budget set out a significant response to the coronavirus outbreak

Given the health impacts and economic disruption already evident in parts of the world with high numbers of coronavirus cases, the Chancellor rightly put mitigating the economic impact at the heart of policy announcements. Indeed, he promised to do "whatever it takes" to support the UK economy through the likely crisis. Last week, we set out a policy package that could address the economic effects of the coronavirus, suggesting three broad priorities: additional funding for health services, support for the overall level of demand in the economy, and support for families and businesses most affected.⁹

Broadly speaking, the Chancellor’s announcements – summarised in Table 1 – addressed all three of these, with a policy package from the Bank of England announced earlier on Budget day doing significant additional legwork on the second.

TABLE 1: The Government announced a £12 billion economic response to the coronavirus
Components of the coronavirus response: 2020-21

<table>
<thead>
<tr>
<th>Theme</th>
<th>Measure</th>
<th>Description</th>
<th>Cost (£bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Support public services</td>
<td>Funding for the NHS, social care and other public services</td>
<td>Extra resources for the NHS, local authority social care services and other public services for treatment and protection</td>
<td>5.00</td>
</tr>
<tr>
<td></td>
<td>Funding for research and testing</td>
<td>Further rapid research and increased capacity for diagnostic testing and surveillance</td>
<td>0.04</td>
</tr>
<tr>
<td></td>
<td>IMF support</td>
<td>A commitment of up to £150 million to the International Monetary Fund to help the effort to stop further transmission and support vulnerable countries</td>
<td>0.15</td>
</tr>
<tr>
<td>Support people</td>
<td>SSP - day one and self-isolation eligibility</td>
<td>Making Statutory Sick Pay available to eligible individuals with coronavirus or self-isolating, and payable from day one instead of day four</td>
<td>0.00</td>
</tr>
<tr>
<td></td>
<td>Removal of ESA waiting days and UC minimum income floor</td>
<td>Universal Credit minimum income floor for the self-employed temporarily relaxed, and contributory Employment and Support Allowance payable from day one of sickness absence rather than day eight</td>
<td>0.50</td>
</tr>
<tr>
<td></td>
<td>Local authority Hardship Fund</td>
<td>For local authorities to support economically vulnerable people and households, mainly via Council Tax Reduction schemes</td>
<td>0.50</td>
</tr>
<tr>
<td>Support businesses</td>
<td>SSP - SME reclaim</td>
<td>Allowing small- and medium-sized businesses (&lt;250 employees) to reclaim coronavirus-related Statutory Sick Pay expenditure for up to two weeks of absence</td>
<td>2.00</td>
</tr>
<tr>
<td></td>
<td>Business Rates - retail, leisure and hospitality discounts</td>
<td>Increasing the Business Rates retail discount to 100% for one year, expanding it to leisure and hospitality, and increasing the planned rates discount for pubs to £5,000</td>
<td>1.00</td>
</tr>
<tr>
<td></td>
<td>Grants to small businesses</td>
<td>Funding for local authorities to support small businesses that already pay little or no Business Rates, via a one-off grant of £3,000</td>
<td>2.20</td>
</tr>
<tr>
<td></td>
<td>Coronavirus Business Interruption Loan Scheme</td>
<td>Loans administered by the British Business Bank to support businesses to access bank lending and overdrafts, with an 80% government guarantee on lending</td>
<td>?</td>
</tr>
<tr>
<td></td>
<td>Time To Pay service for tax liabilities</td>
<td>Additional resource (a further 2,000 call handlers) for the already-established Time To Pay service that can spread out the repayment of tax debts to HM Revenue and Customs</td>
<td>?</td>
</tr>
</tbody>
</table>


Considering just the direct coronavirus response measures, Table 2 shows that their scale is within the range of responses seen in other countries that have announced specific coronavirus measures (Australia’s package was announced as this report was being finalised). The UK’s swift combination of monetary and fiscal stimulus stands out compared to the central bank going it alone in the US and only individual Eurozone countries offering fiscal responses to date, with no action from the European Central Bank. When combined with other, non-coronavirus, spending increases of £18 billion in 2020-21 (much of which had been announced in the 2019 Spending Review), the total fiscal stimulus in 2020-21 is £30 billion or 1.3 per cent of GDP, above that seen in other countries to date.
TABLE 2: Other countries have announced a range of packages to combat the economic effects of the coronavirus
Responses to the coronavirus outbreak, various countries

<table>
<thead>
<tr>
<th>Theme</th>
<th>Monetary Policy</th>
<th>Fiscal Policy</th>
<th>Total stimulus (excl. effect of rate cuts)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Measure</td>
<td>Rate cuts</td>
<td>Liquidity support for financial sector</td>
<td>Health spending</td>
</tr>
<tr>
<td>UK</td>
<td>-50bp</td>
<td>Launch of new Term Funding Scheme for SMEs (c. £100bn); macro-prudential loosening</td>
<td>Funding for the NHS, research and testing: $6.7bn</td>
</tr>
<tr>
<td>Ireland</td>
<td>No</td>
<td></td>
<td>Reforms to Sick Pay, including for the self-employed: $2.7bn</td>
</tr>
<tr>
<td>US</td>
<td>-50bp</td>
<td>Vaccine development: $8.3bn</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>No</td>
<td></td>
<td>$0.5bn</td>
</tr>
<tr>
<td>China</td>
<td>No</td>
<td></td>
<td>$15.9bn</td>
</tr>
<tr>
<td>France</td>
<td>No</td>
<td></td>
<td>Partial unemployment benefit for time lost as a result of virus</td>
</tr>
<tr>
<td>Italy</td>
<td>No</td>
<td></td>
<td>$11.9bn</td>
</tr>
<tr>
<td>South Korea</td>
<td>No</td>
<td>Disease prevention and treatment: $1.9bn</td>
<td>Support for consumption and employment: $5.9bn</td>
</tr>
</tbody>
</table>

NOTES: All financial values in US dollars.
Support for the macroeconomy

Coronavirus will affect both the demand and supply sides of the economy – possibly very significantly – implying a need for timely measures to offset the impact. Supply is likely to be affected in a number of ways, including workers falling ill, disruption preventing firms from importing vital components, and factories being forced to close to stem the spread of the virus. But the virus will also lead to weaker demand because people travel less and avoid social congregation (such as going to restaurants), and because businesses may cancel major investment projects. Although the coronavirus pandemic will eventually reduce in its intensity, the economic effects could have a long-lasting impact on the economy if, for example, otherwise viable and productive firms go bankrupt. As discussed above, although the size of the coronavirus impact on the economy is very uncertain, it could be large if the outbreak spreads throughout the UK. And, because it takes time for policies put in place to support the economy to have an effect, there is a need to respond quickly, and to provide substantial support to the economy.

The first port of call for providing support to the economy is cuts in interest rates. It is therefore very good news that the Bank of England announced an emergency cut in its policy rate on the morning of Budget day from 0.75 per cent to 0.25 per cent. This was the first unscheduled rate cut since the financial crisis, taking rates back to their all-time lowest level reached in the aftermath of the EU referendum in 2016.

The Bank of England also announced measures to support the banking sector and businesses. Most eye-catching is the introduction of a new Term Funding Scheme, with extra incentives for lending to small and medium-sized enterprises (SMEs). This scheme will provide cheap funding to commercial banks to lend to SMEs, incentivising extra lending, particularly to help them through a period of economic disruption. In addition, the Bank of England’s Financial Policy Committee has reduced the amount of capital UK banks have to hold, supporting up to £190 billion of bank lending to businesses.

But there is limited scope for the Bank of England to provide additional support to the economy, and certainly for further cuts in interest rates. While the latest cut may provide sufficient support (together with the other measures announced in the Budget) if the economic impact of coronavirus is limited, it will not be enough in the event that the situation deteriorates. And while the Bank of England could extend its ‘Quantitative Easing’ (QE) bond-buying programme, recent falls in longer-term interest rates to all-time lows limit the effectiveness of this policy.

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This means further support from fiscal policy may well prove necessary. Fiscal policy can be particularly powerful in this context because temporary economic disruption can be met by additional – but temporary – government spending. So it is fortuitous that the Government’s 2019 Spending Round had already announced a significant ramping up in spending in 2020-21, as discussed above. But the fact that this stimulus is only coincidental to the virus outbreak means it will be neither optimally timed nor optimally targeted. So, if the outlook deteriorates sharply, it is likely that more fiscal support will be needed.

Overall then, the Budget, combined with announced measures from the Bank of England, amounted to significant and coordinated support for the macroeconomy. Looking ahead, however, more may be needed. If so, further fiscal support is likely to be a crucial policy lever.

Support for families and businesses

With the Bank of England’s measures and the wider impact of spending decisions in this Budget doing the work on macroeconomic support, the Chancellor’s coronavirus-specific package (Table 1) focused on supporting families and businesses, and supporting the health service.

For businesses, the Chancellor announced a range of measures, including a Statutory Sick Pay (SSP) rebate for small and medium firms; tax breaks for small businesses in service sectors likely to be particularly affected by coronavirus; grants for very small firms; a loan guarantee scheme; and additional resource for the ‘Time To Pay’ scheme that spreads out business tax bills. On the latter, it is worth noting that businesses made widespread use of this option during the financial crisis, with £7.4 billion worth of tax debt delayed between November 2008 and end March 2011.

Overall, this represents a welcome and comprehensive package of support, with a well-targeted focus on smaller firms that are likely to be capable at least of weathering a temporary shock on the basis of their reserves or conventional credit. The ability to reclaim a full two weeks of SSP for all coronavirus-related absence will be particularly reassuring to many firms, and goes further than just reintroducing a previously abolished scheme that only compensated firms for very high SSP costs.

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11 Initially launched as part of the ‘Business Payment Support Service’ within HM Revenue and Customs (HMRC) in September 2008, ‘Time To Pay’ arrangements are plans agreed to spread out the repayment of tax debts over a longer time period. The most recent accounts published by HMRC recorded 795,000 Time To Pay arrangements worth £2.3 billion in place in 2018-19. See: HM Revenue and Customs, 2018-19 Annual Report and Accounts, July 2019.


For families, the Chancellor announced that all employees eligible for SSP will receive it while self-isolating (whether or not they are actually ill), on top of the previously announced commitment that SSP will be paid from day one of a coronavirus-related absence. For self-employed workers not eligible for SSP, he increased support via the benefits system. The seven-day waiting period in Employment and Support Allowance (ESA) has been removed, and the ‘minimum income floor’ that limits support for low-earning self-employed people in Universal Credit (UC) has been temporarily relaxed (but only for those affected by coronavirus). In addition, a £0.5 billion Hardship Fund has been allocated to local authorities to provide support, mainly via Council Tax Reduction.

These measures are welcome, but the relative focus on firms rather than individuals affected is very clear. Two issues are worth highlighting. First, the Chancellor missed an opportunity to extend eligibility for SSP to the 2 million employees who earn too little to be eligible. This group will not be entitled to contributory ESA either, and a significant minority (one third) of them either live alone, or live with a partner who is either workless or earning too little to be eligible for SSP themselves. The main support available to these low-paid workers is Universal Credit (UC), which is less generous than SSP and brings with it the challenges of the well-publicised five-week wait and means testing. Indeed many of those falling ill would get no support at all if they had financial savings or a partner whose earnings took them out of the UC means-test. What is frustrating is that the Government had an answer up its sleeve: last year, the previous government proposed that those earning below £118 per week should receive SSP at 80 per cent of their usual pay (and such a reform would have been easier to sell to employers now that the Government is also covering the cost of SSP to SMEs). Failing to extend support to the lowest earners through the coronavirus outbreak represents a missed opportunity to support families.

Second, the Government’s package did little to address the generosity of support (either from SSP or the benefits system) available to workers affected by coronavirus. As Figure 20 shows, both means of support replace less than one-third of typical earnings for the relevant group. Also, levels of SSP compare poorly to the minimum income standard. Given the rising proportion of low-income families without savings, and the positive effect that boosting the incomes of these groups would have on consumer spending, this

15 Source: RF analysis of ONS, Family Resources Survey.
16 For more details, see: K Handscomb, Coronavirus and the benefits system: What support is available?, Resolution Foundation, March 2020.
17 Department for Work and Pensions/Department for Health and Social Care, Health is everyone’s business: proposals to reduce ill health-related job loss, July 2019.
also feels like a missed opportunity. The Government’s lack of action here contrasts with Ireland, which has just increased rates of sick pay by 50 per cent.

FIGURE 20: The generosity of support for those self-isolating or off sick is low
Replacement rates for those experiencing sickness absence from work: 2019-20

NOTES: When comparing to the minimum income standard, we do not account for the impact of taxes and benefits, because weekly SSP rates are far below Income Tax and National Insurance Thresholds, and single adults experiencing sickness absence for two weeks in a month are unlikely to claim (or be eligible for) Universal Credit in practice. SSP-eligible employee earnings are estimated by adjusting median weekly earnings across employees according to the characteristics of employees eligible for SSP only, as opposed to more generous occupational sick pay schemes. For details, see: T Bell, L Gardiner, R Hughes, J Smith & T Yates, A Budget action plan: The economic response to the coronavirus, March 2020.


The Government’s decision to spend is broader than the coronavirus response – spending is set for historically large increases

Alongside the measures announced to respond to coronavirus, the most consequential announcement from the Chancellor at this Budget was the setting of the envelope for overall departmental spending out to 2023-24 for current spending and 2024-25 for capital. These totals are a necessary first component of the spending review process, which itself allocates them to departments later this year. Constraining them may well turn out to be the only substantive role played by the fiscal rules of the Conservative manifesto.

The totals announced bring Total Managed Expenditure (TME) above £1 trillion for the first time in the UK’s history, and mark a decisive shift from those set out in March 2019. As Figure 21 below shows, the result of this fiscal expansion is that the size of the state
(i.e. the share of the economy taken up by government expenditure) is set to rise from the current level of 40 per cent to 41 per cent – higher than at any point during Tony Blair’s term in office.

FIGURE 21: The Spending Review 2020 envelope has been set, with total government spending surpassing £1 trillion by the end of the Parliament
Total managed expenditure as a proportion of GDP, outturn and successive OBR projections

The Chancellor pitched this large increase in spending as the core long-term component of the Budget, exclaiming that “the central judgement I’m making today is to fund an additional £175bn over the next five years for our future prosperity.”\textsuperscript{19}

As is traditional at Budget time, this figure given was not adjusted for inflation and was simply a summing up of the cash increases in spending across the five years of the forecast period. It includes some things that are not traditionally treated as ‘departmental’ spending, such as £14 billion of additional Annually Managed Expenditure (AME), and excludes some others, such as the earmarked (though subject to change) increase in spending in 2020-21 that is part of the Government’s response to coronavirus.

Figure 22 contains our estimate, based on the OBR’s forecasts, for the increase in departmental spending over the next five years: £203 billion. This comprises an additional £61 billion of (net) departmental capital spending (CDEL) and an additional £142 billion of current/resource departmental spending (RDEL).

As well as accounting for the temporary, but significant, extra departmental spending to tackle the effect of coronavirus on our health and our economy in 2020-21 (£8 billion), we have also taken a judgement as to the total amount of extra spending freed up by the decision to leave the EU. This is necessary because part of the extra spending allocated to departments as a result of the decision to leave the EU (£42 billion over the five years) is not truly additional in so far as EU funds already contribute to spending in the UK, e.g. through the Common Agricultural Policy and Structural Funds. To paraphrase the Chancellor, not all of the “billions of pounds we would have sent to the EU” are now additional funds that can be “spent on our priorities”. The UK government will have discretion over how to spend this funding – as our politics is about to discover – but around £5 billion a year of this money was already being spent in the UK, so isn’t really ‘new’ in so far as our departments, and public services, are concerned.

Stepping back from the detail, this is a very large package of additional spending – a full 180-degree pivot away from the austerity of the 2010s: not least because the majority of the funding for this extra spending is found via a large increase in borrowing. This extra borrowing more than provides the funding for increases in capital spending. When it comes to increases in current spending, tax increases, the indirect effects of government...
decisions (namely, the boost to the public finances from higher spending, and the impact of the National Living Wage) and the extra funding returning to the UK budgets from the EU also play a part, as shown in Figure 23.

**FIGURE 23: The extra spending announced at this budget is funded primarily by borrowing**

Change in spending, borrowing, tax revenue and additional funds previously spent in the EU

How do these increases compare to the size of changes in departmental spending set out at previous fiscal events? Figure 24 shows how the announced growth rates in CDEL, RDEL and Total DEL (TDEL) compare with those set out at each spending review since 2000.
FIGURE 24: Capital spending is set to increase very fast in coming years, day-to-day spending less so

Average annual change in departmental spending as detailed at each spending review

RDEL is now set to grow by a faster amount than was set out in any spending review since 2004, by an average of 2.8 per cent, over the years from 2020-21 to 2023-24. CDEL is set to grow by 4.2 per cent per year on average over the slightly longer time period to 2024-25. Both capital and current spending will be growing significantly faster than at any point since 2010, with the exception of the Spending Round 2019 increases set to take effect in 2020-21.

The centrepiece of the government’s big decision to spend is the ‘infrastructure revolution’

While the expansion in spending in response to coronavirus reacts to very recent developments in the global economy, significant increases in capital spending have been anticipated for much longer, and formed a key part of the Conservative manifesto last year. Although the Chancellor’s ‘infrastructure revolution’ might have been eclipsed by the need to deal with an emerging global threat, public sector net investment is still

20 The coronavirus-related spending increase in 2020-21 has been excluded from the baseline for assessing spending growth rates in SR20.
set to total £330 billion in real terms over the next five years, due to a £100 billion (gross) increase in capital spending. This will more than reverse all cuts to departmental capital spending since 2010, as shown in Figure 25.

FIGURE 25: Capital spending is set to exceed 2010-11 levels
Indices of real (GDP-deflator-adjusted) capital departmental expenditure limits (2010-11 = 100)

This represents a big turning point in investment spending, after years of relative under-investment, both by Britain’s own historical, as well as international, standards. The projected increase to 3 per cent of GDP by 2024-25 would take the UK above its post-war average investment rate of 2.7 per cent, and close to OECD averages of around 3.2 per cent by the end of the Parliament, as shown in Figure 26. At 2.9 per cent of GDP over the Parliament, this is the highest average level of public sector net investment over five years since the late 1970s. This results in the Government exactly reaching its 3 per cent investment limit by 2024-25, even allowing for the OBR’s assumption of a roughly 20 per cent underspend on extra investment spending.

21 This refers to the OBR’s forecast of investment net of depreciation, rather than the Chancellor’s £640 billion total nominal investment over the parliament, which also refers to gross investment spending.
22 This estimate of underspend is based on historical experience and the speed with which the Government intends to ramp up capital spending.
FIGURE 26: Public sector net investment is projected to rise above the post-war average

Public sector net investment as a proportion of GDP, outturn and successive OBR projections

NOTES: Post-war average refers to the years 1948 to 2018-19.
SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, various; OBR, Public Sector Finances Database; OECD, Economic Outlook, November 2019.

However, many of the big questions over what the nearly £100 billion of extra capital spending in the Budget will actually be spent on remain to be answered in the Spending Review later this year. Building on the Conservative manifesto, the Budget contains a raft of announcements on capital spending. These include the Chancellor’s £500 million a year pot-hole fund, as well as funding for flood defences, road networks and promised funding for 40 new hospitals. But a lot of the capital spending promised remains unallocated in the Budget costings – 57 per cent of the total, as Figure 27 shows.
FIGURE 27: Most of the Government’s ‘infrastructure revolution’ remains unallocated

Public sector gross investment, Spring Budget 2020 and unallocated, by type

NOTES: Allocated totals assume that capital spending commitments set out in the Budget scorecard in 2020/21 are maintained over the Parliament and that manifesto spending commitments are maintained in nominal terms in 2024/25.

SOURCE: RF analysis of HMT, Spring Budget 2020 documents; Conservative party, General Election Manifesto 2019.

So far, investment spending that has been costed in detail has been slightly skewed towards economic infrastructure, with funding for research and development accounting for over a quarter of allocated capital spending, and transport 8 per cent. However, compared to the Conservative manifesto capital spending promises – only 6 per cent of which related to social infrastructure – Figure 27 shows that social infrastructure now makes up just under a third of the allocated portion of the capital spending envelope. This is largely due to the commitment to £1 billion of NHS capital investment for a promised 40 new hospitals, as well as a building safety fund (also worth more than £1 billion) to remove unsafe cladding from residential buildings. Both of these are welcome commitments given the UK’s historical underinvestment in social infrastructure – particularly in the maintenance of social housing and hospital equipment.23

Also welcome is the renewed commitment to the Shared Affordable Homes Programme for 2016-2021, with £9.5 billion of new funding making this marginally more generous than the current programme. However, with the bulk of the detail on the Government’s capital spending postponed until the Spending Review, there are still significant decisions to

make. Many of these decisions will involve the Government’s commitments to ‘level up’ infrastructure and living standards in regions outside London and the South East – discussed in Box 2.

It’s also welcome news that – given the scale of his investment ambitions – the Chancellor is launching reviews on various aspects of the management of public investment. Improvements to the process of investment management will be crucial if we are to minimise wasteful inefficiencies and focus on the right priorities over the next five years. The Chancellor specifically announced plans to review the ‘Green Book’ manual on project appraisal and evaluation, with a focus on “how decisions on major investment programmes are appraised in order to make sure that government investment spreads opportunity across the UK”.24 Welcome though this is, it should also consider the more fundamental issue of how to re-adjust selection processes to take account of risks associated with climate change. While it’s important to ensure the benefit of a more equal profile of investment across regions is captured, it is also essential to ensure that the long-term net benefits of transformational investment in climate change mitigation are considered in investment decisions.

As part of the announced fiscal framework review, the Budget included plans to “consider options to support and strengthen the practices and institutions that deliver the UK’s fiscal framework”, which includes the National Infrastructure Commission (NIC). Improvements in the oversight of project selection and implementation will also be necessary, and the review of the role of the NIC is particularly welcome. It should result in a bolstering of their independence as an institution. The NIC would be ideally placed to have their remit increased to certify the Treasury’s analysis underpinning the business cases for large-scale projects – providing expert advice on project costs and benefits.25

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**BOX 2: Levelling up?**

The Conservative party’s 2019 General Election manifesto committed the Government to a ‘levelling up’ agenda intended to spread “opportunity across the whole United Kingdom”.26 While the agenda’s more detailed aims have appeared somewhat opaque, infrastructure investment is set to play a significant role. To date, regional differences in capital investment have in fact been substantial. For instance, recent Resolution Foundation research

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found that in 2018-19, total public investment per capita was £1,200 in London and the South East of England—more than 35 per cent higher than the £885 per head invested in the other regions.\(^{27}\)

In Spring Budget 2020, the Chancellor reiterated his commitment to “invest more in our nations, cities and towns”.\(^{28}\) Although detailed capital allocations are not included in the Treasury’s policy costings, the Budget did include the announcement of a new devolution deal for West Yorkshire and, from 2022-23, a five-year funding settlement for the eight mayoral combined authorities,\(^{29}\) worth a total of £4.2bn. Other large announcements included confirmation of the second Road Infrastructure Strategy, with an allocation of £27bn between 2020 and 2025.

Welcome though these measures are, levelling up living standards across different regions of the UK will require more than capital investment:

- First, capital investment is long term in its very nature and therefore limits the Government’s ability to achieve many ‘quick wins’ outside of investments in areas like hospitals and roads.
- Second, skills and education – which fall outside of these infrastructure investments – also drive regional differences in earnings and productivity. Resolution Foundation research has shown that the proportion of 25-28 year olds with degrees in inner London is nearly twice as large as the share of young people with degrees in several other regions, including the West Midlands metropolitan area.\(^{30}\) On this basis, today’s announcement of a £1.5bn capital investment in English further education college’s estates, spread over five years, is welcome. On an annual basis this would equate to more than double the amount of capital investment that colleges have received from government annually (£130 million) over recent years.\(^{31}\)
- Third, services will also have a substantial role to play in the levelling up agenda. Recent Resolution Foundation research noted that raising current spending delivered via local councils, combined authorities, and police and fire services could prove more effective in reversing worrying trends that have run counter

\(^{27}\) A Bailey, R Hughes, L Judge & C Pacitti, Euston, we have a problem: Is Britain ready for an infrastructure revolution?, Resolution Foundation, March 2020.

\(^{28}\) R Sunak, Spring Budget 2020: Rishi Sunak’s speech, HM Treasury, March 2020

\(^{29}\) The eight Mayoral Combined Authorities include: West Yorkshire, Greater Manchester, West Midlands, Liverpool City Region, Tyne and Wear, West of England, Sheffield City Region and Tees Valley.

\(^{30}\) K Henehan, Pick up the pace: The slowdown in educational attainment growth and its widespread effects, Resolution Foundation, March 2019.

to the aims of a levelling-up agenda.32 So to that extent, today’s funding settlement for the Mayoral Combined Authorities should in particular be welcomed.

• Fourth, differences in family finances (discussed in more detail below) also drive up regional living standards inequalities, and these should form a substantial part of the levelling up agenda in future. This is particularly the case with regard to changes in the welfare system: for instance, the 50 seats that were gained by the Conservatives from Labour in the North East and West, Yorkshire and the Humber, the East and West Midlands, and Wales have been more exposed to reduced working-age welfare generosity over recent years.33

The unwinding of austerity for public services is set to continue, albeit at a slower pace

The Government has placed capital spending at the front and centre of the Budget, but the increase in day-to-day spending set out by the Chancellor is also much larger than anything announced by previous Conservative governments throughout the 2010s. This Budget builds on the austerity-ending theme of the 2019 Spending Round.

The OBR’s RDEL forecast is set out in Figure 28, below. We have adjusted RDEL spending totals here to take account of both the impact of coronavirus and our assessment of how much of the additional funding from leaving the EU is actually ‘new’ money so far as departments are concerned (see above for more details).

After nine years of falls in departmental spending from 2009-10 to 2018-19, over which time real terms RDEL fell by 9 per cent, a £30 billion reduction in real terms (2019-20 prices), a corner has now been turned and real RDEL is set to increase by 17 per cent or £51 billion from 2018-19 to 2024-25, and is set to surpass 2009-10 levels in 2021-22.

32 Between 2009-10 and 2018-19, local current spending per capita (excluding education) fell by 12 per cent in the South East, compared to 21 and 24 per cent in the North East and North West, respectively. See: A Corlett, J Leslie & D Tomlinson, The trillion-pound question: Spring Budget 2020 and the tension between higher spending, low taxes and fiscal credibility, Resolution Foundation, February 2020.

33 C McCurdy, L Gardiner, M Gustafsson & K Handscomb, Painting the towns blue: Demography, economy and living standards in the political geographies emerging from the 2019 general election, Resolution Foundation, February 2020.
Adjusting for changes in the size of the population, however, paints this increase in a light more reflective of how spending levels compare with the actual demands on public services. On this metric, although austerity is being reversed in the years ahead, day-to-day departmental spending per person in 2024-25 will still be 3 per cent below 2009-10 levels. If measured relative to GDP, spending is also set to rise in the first half of the 2020s, but will remain 8 per cent below 2009-10 levels by 2024-25.

However, these overall totals hide vast differences in the direction and magnitude of changes in spending at the departmental level, and the spending increases pencilled in for the coming years will by no means fully reverse the last decade of cuts for all departments.

Figure 29 shows how per capita RDEL budgets across departments changed in the period up to 2019-20 and how they might do so in the period to 2024-25. As of 2019-20, real-terms per capita resource spending in the Department for Transport had been cut by 57 per cent since 2009-10, the Work and Pensions budget had been reduced by 54 per cent and the Housing and Communities budget cut by 53 per cent.
FIGURE 29: Departmental spending increases will by no means fully reverse austerity across Whitehall

Cumulative real-terms (GDP-deflator-adjusted) change in per-capita RDEL since 2009-10

NOTES: Figures are adjusted as far as possible to account for machinery of government changes.

Not every department faced cuts over this period: the Department for Health and Social Care’s (DHSC) budget increased by 11 per cent in real per-capita terms between 2009-10 and 2018-19, while the International Development budget increased by 7 per cent.

Taking the increase to departmental budgets for 2020-21 as set out in Spending Review 2019 and announcements leading up to and in the Spring Budget 2020, Figure 29 also shows where the different departments might expect to find themselves by 2024-25 if unallocated spending was shared equally across departments. The big story is increases in departmental spending across the board. However, expected increases of over a quarter (26 per cent) in Health and Social Care relative to 2009-10 levels, stand in direct contrast to assumed cuts of half or more for Housing and Communities (49 per cent) and Transport (50 per cent). Despite big increases in departmental spending, and some big reversals, these increases will by no means fully reverse austerity across Whitehall.

The stark differences in changes to departmental budgets since 2009-10 mean that the shape as well as the size of the state has changed over the past decade. In 2009-10 the

34 Growth rates in departmental spending in forecast years are calculated from HM Treasury figures where possible, or instead are derived from the OBR’s RDEL forecast.
RDEL budgets of the health department alone comprised 31p in every £1 of total day-to-day spending, while they now (in 2020-21) account for 40p in every £1 spent. The growing budgets of the DHSC alongside Defence and International Development reflects their protected status since 2010 and mean that it is important to disentangle the trends in spending between these protected areas and all other unprotected departmental spending. This split between ‘protected’ and ‘unprotected’ departments, as well as the overall trend in RDEL per capita since 2009-10, is depicted in Figure 30.

**FIGURE 30:** Real per capita RDEL spending on protected departments is expected to rise by almost a fifth between 2009-10 and the end of Parliament

Indices of real (GDP-deflator-adjusted) per-capita resource departmental expenditure limits (2009-10 = 100), across ‘unprotected’ departments and ‘protected’ departments

This is not just about the legacy of previous departmental protections. Between 2019-20 and 2024-25, protected departments’ budgets are set to grow by around 2.6 per cent each year. In comparison, unprotected budgets are set to grow by just 1.9 per cent a year in this Parliament – with an extra £43 billion (2019-20 prices) allocated to their budgets in 2024-25 compared with 2019-20. Austerity is ending, but it is being reversed at a slow

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pace for some departments. It will be far from reversed in some parts of Whitehall and local government even by the mid-2020s.

In Figure 31 we detail how much extra money the Government would need to spend in order to partially or fully reverse austerity for unprotected departments on two different metrics. In real per capita terms, an extra £10 billion would be required to reverse half of the cuts to unprotected departments, with an extra £39 billion required to reverse all of the cuts that took place in these departments place since 2009-10.

**FIGURE 31: Reversing austerity over the next five years will cost tens of billions of pounds**

Increase in day-to-day departmental spending required in 2024-25 to reverse austerity (GDP-deflator adjusted), 2019-20 prices, various measures

<table>
<thead>
<tr>
<th>Extra increase to…</th>
<th>2020-21 to 2024-25 increase</th>
<th>2019-20 to 2020-21 increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>£0bn</td>
<td>£10bn</td>
<td>£8.1bn</td>
</tr>
<tr>
<td>£10bn</td>
<td>£12.0bn</td>
<td>£25.8bn</td>
</tr>
<tr>
<td>£20bn</td>
<td>£20bn</td>
<td>£39bn</td>
</tr>
<tr>
<td>£30bn</td>
<td></td>
<td></td>
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<tr>
<td>£40bn</td>
<td></td>
<td></td>
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<tr>
<td>£50bn</td>
<td></td>
<td></td>
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<tr>
<td>£60bn</td>
<td></td>
<td></td>
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<tr>
<td>£70bn</td>
<td></td>
<td></td>
</tr>
<tr>
<td>£80bn</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**…reverse half of austerity for unprotected depts**  
**…reverse austerity in full for both protected and unprotected depts**  
**…reverse austerity in full for unprotected depts**


Austerity has been ended, but the full decision on which parts of government will most benefit from its unwinding is yet to be made. For that decision, we await the forthcoming Spending Review later in 2020.

**Despite the big increase in spending, this Budget was silent on arresting ongoing welfare cuts, falling incomes at the bottom and rising child poverty**

In contrast to large commitments across coronavirus-related, current and capital expenditure, this Budget had notably little to say in one area of spending – the social security which directly supports low-to-middle income families.
Since 2015, family finances have endured significant headwinds in the form of welfare cuts. And while some of these policies, such as the benefits freeze, have ended – meaning those benefits are no longer being reduced in real terms – the full impact of others is still to be felt.

Their impact is delayed because some of these welfare reductions only apply to new claims made or new children born since April 2017. As Figure 32 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 £2.5 billion by 2024-25. Almost another £2 billion will be added on top of that by the time the full effect of these policies is felt (accumulating over more than a further decade).36

**FIGURE 32: There are more working-age welfare cuts still to come**

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

<table>
<thead>
<tr>
<th>Years</th>
<th>Abolition of the work-related activity component</th>
<th>Abolition of the family element</th>
<th>Two-child limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020-21</td>
<td>-£0.3bn</td>
<td>+£0.1bn</td>
<td>-£0.2bn</td>
</tr>
<tr>
<td>2021-22</td>
<td>-£0.6bn</td>
<td>+£0.2bn</td>
<td>-£0.2bn</td>
</tr>
<tr>
<td>2022-23</td>
<td>-£0.9bn</td>
<td>+£0.3bn</td>
<td>-£0.4bn</td>
</tr>
<tr>
<td>2023-24</td>
<td>-£1.2bn</td>
<td>+£0.4bn</td>
<td>-£0.5bn</td>
</tr>
<tr>
<td>2024-25</td>
<td>-£1.6bn</td>
<td>+£0.4bn</td>
<td>-£0.4bn</td>
</tr>
</tbody>
</table>

**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.

Despite almost no word on welfare in this Budget, outside of the coronavirus response, these ongoing welfare cuts are not the only big thing happening to social security in

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the coming years. It is in this Parliament that most of the Universal Credit roll out will happen, (although the OBR now think that it won’t be complete until 2026, saving the Government some money).  

FIGURE 33: London is the only UK region with more UC gainers than losers

Proportion of benefit-recipient families that gain and lose from the switch to UC, compared to the legacy benefits system, by region: 2015-18

NOTES: Modelling is based on the population in 2015-18, but assuming that the UC system is fully in place. Modelling is on a take-up basis, accounting for higher benefit take-up in the UC system than in the legacy system. The population captured within this analysis includes families receiving either UC or legacy benefits (or both). Gains and losses less than £1 per week are excluded.

SOURCE: RF analysis of DWP, Family Resources Survey; ONS, Quarterly Labour Force Survey, using the IPPR tax-benefit model.

And while the UC system is now likely to be roughly as generous in aggregate terms as the one it is replacing (with the welfare cuts discussed above affecting both), this masks millions of families gaining and millions losing out. This is pertinent to the new Government’s agenda because these gainers and losers are clustered in different parts of the country. As Figure 33 shows, there are proportionally more UC net losers in much of the North, Midlands and Wales compared to London and the South East. The regional differences are in part driven by higher housing costs in the latter areas, and the relative – and welcome – additional support UC provides to working families facing these costs. Because aggregate UC spending roughly matches the legacy system, however, UC is

37 In the past, the OBR has extended the Department for Work and Pensions’ (DWP’s) timetable by six months to account for the likelihood of further delays, but it has now extended DWP’s latest revised timetable by two years, to September 2026. This suggest that from start to finish the roll-out of UC will have taken over 13 years. Even on this slower timetable, the UC caseload is expected to grow from 2.0 million in 2019-20 to 4.9 million in 2024-25. And this delay in delivery has real-world implications for the level of support paid to families. According to the OBR, the slower timetable is estimated to save up to £0.9 billion a year over the forecast period due to “the costs for those who gain under UC and transitional protection paid to those who would lose out from a managed move to UC” being postponed.
typically less generous than the system it replaces for many with lower housing costs. Alongside their greater exposure to broader welfare cuts happening across both UC and the legacy system, the clear conclusion is that families in the areas of the country on which levelling up is focused are more negatively affected by current changes to social security.\textsuperscript{38}

The changes discussed above are only some of the welfare policy changes that have been introduced over the past five years. Bringing together all of these changes (including some benefit increases), together with tax policy changes, Figure 34 shows the overall impact of benefit and tax policy choices on households across the income distribution since Summer Budget 2015. Given that welfare support is targeted at lower-income households, and that the 2015 package of welfare cuts was so substantial (including the benefits freeze and two-child limit), the average losses for poorer households are very large. For example, the second decile will ultimately be £2,900 a year worse off (on average) than if welfare policy had remained unchanged, with £900 of that still to come as a result of welfare policies still being rolled out.

**FIGURE 34: The overall shape of tax and benefit policies announced since 2015 remains highly regressive**

Impact of tax and benefit policies announced since March 2015 on annual disposable household income (after housing costs): 2024-25

NOTES: Assumes full roll-out of UC, and the steady-state impact of welfare policies still being rolled out. Welfare impacts still to come refer to the remaining impact of the two-child limit and family element abolition. Other benefit policies include the four-year freeze and free childcare for working parents of three and four year olds. Tax policies includes changes to Income Tax, National Insurance, pension tax relief, Fuel and Alcohol Duty, and Entrepreneurs’ Relief.

SOURCE: RF analysis using the IPPR tax-benefit model; DWP, Family Resources Survey; ONS, Living Costs and Food Survey.

\textsuperscript{38} C McCurdy, L Gardiner, M Gustafsson & C Handscomb, Painting the towns blue: Demography, economy and living standards in the political geographies emerging from the 2019 General Election, Resolution Foundation, February 2020.
Welfare cuts have been somewhat offset (in aggregate) by tax cuts. Successive cuts to Income Tax, through increases in the personal allowance and higher-rate threshold, have been followed in this Budget by an increase in the starting point for National Insurance (discussed further below), as well as repeated Fuel Duty freezes. But these changes have been of most benefit – in cash terms – to the top half of the income distribution, though this has been tempered at the very top by tax increases targeted at the richest tenth of the population.

Table 3 demonstrates the real-world effects of these tax and benefit policy changes on the earnings and income of specific families. For households with earners on the wage floor, the introduction of the National Living Wage, and subsequent increases in its generosity, have delivered a welcome income boost. But for families with children, even this boost is greatly offset by the fall in benefit incomes.

For example, a couple with three children and both adults in work gains around £1,330 from the NLW increase, but loses almost £5,000 due to changes in benefit entitlement. Comparing net income in 2024-25 to what might have been, that is a loss of around £3,300. Similarly, a single parent working 20 hours with one child gains £1,330 from increased earnings, but faces an overall loss of £2,700 due to a £4,000 reduction in their benefits.

Conversely, tax reductions have the largest absolute effects on higher-income households. For instance, a couple earning at the 90th percentile, with earnings of £132,650, has gained around £2,400 from changes to tax policy, whereas a couple with members earning at the 25th percentile and the wage floor, with combined earnings of £33,280, gains just by £250.
TABLE 3: The National Living Wage offers a welcome income boost for earners on the wage floor, but for families with children this is more than offset by cumulative welfare cuts since 2015

Annualised impact of policy changes since 2015 for different family types: 2024-25

<table>
<thead>
<tr>
<th>Family Type</th>
<th>Gross household earnings, 2024-25</th>
<th>Effect of policy changes since 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross earnings change</td>
<td>Income change from change in taxes paid</td>
</tr>
<tr>
<td>1. Single (no children), full time, self-employed, low earning</td>
<td>£20,900</td>
<td>+£2,500</td>
</tr>
<tr>
<td>works 37.5 hours per week and earns equivalent of NLW per hour</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Single (no children), full time, earning wage floor</td>
<td>£20,900</td>
<td>+£2,500</td>
</tr>
<tr>
<td>works 37.5 hours per week at NLW, rents privately at 30th pctile</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Single (1 child), part time, earning wage floor</td>
<td>£11,150</td>
<td>+£1,330</td>
</tr>
<tr>
<td>works 20 hours per week at NLW</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Single (1 child), full time, low earning, renting</td>
<td>£22,130</td>
<td>+£0</td>
</tr>
<tr>
<td>works 37.5 hours per week at p25 wage, rents social housing at average rents</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Couple (2 children), full time single earner on wage floor</td>
<td>£20,900</td>
<td>+£2,500</td>
</tr>
<tr>
<td>main earner works 37.5 hours per week at NLW</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Couple (2 children), low earning/wage floor, renting</td>
<td>£33,280</td>
<td>+£1,330</td>
</tr>
<tr>
<td>main earner works 37.5 hours per week at p25 wage, second earner works 20 hours per week at NLW, rents privately at 30th pctile</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Couple (3 children), low earning/wage floor, renting</td>
<td>£33,280</td>
<td>+£1,330</td>
</tr>
<tr>
<td>main earner works 37.5 hours per week at p25 wage, second earner works 20 hours per week at NLW, rents privately at 30th pctile</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Couple (no children), low/mid earning</td>
<td>£42,190</td>
<td>+£0</td>
</tr>
<tr>
<td>both work 37.5 hours per week, main earner at median wage, second earner at p25 wage</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. Couple (2 children), low/mid earning</td>
<td>£52,520</td>
<td>+£0</td>
</tr>
<tr>
<td>both work 37.5 hours per week, main earner at median wage, second earner at p25 wage</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. Couple (no children), high earning</td>
<td>£132,650</td>
<td>+£0</td>
</tr>
<tr>
<td>both work 37.5 hours per week at p90 wage</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

NOTES: Figures are based on full roll-out of Universal Credit and all benefit, tax and National Living Wage policies implemented since 2015. All figures modelled in 2024-25 using the latest OBR economic forecast for appropriate uprating factors. Childcare support included in benefit award. Policies include: changes to personal allowance, Income Tax thresholds, and National Insurance contributions; original National Living Wage policy and increase to two-thirds of median earnings; the four-year benefits freeze, the changes to UC work allowances, the two-child limit and the removal of the family element. UC Childcare element is calculated on the basis of full take-up of the free childcare entitlement. Council Tax bills are assumed to be unchanged. All adults are aged over 25. No behavioural changes or dynamic effects are assumed. Figures are rounded to nearest £10.

SOURCE: RF analysis using RF microsimulation model.
Overall then, tax and benefit policy over the past five years has clearly been regressive, with the poorest losing the most both in proportional and in cash terms. Already, welfare cuts have resulted in the incomes of the poorest families actually falling over the past two years.39 And child poverty risks hitting a record high during this parliament.40 The Budget was almost entirely silent on welfare policy, but the effects of this element of the 2010s austerity package endure, and will be felt more by certain groups and – importantly for this Government’s ambitions – in certain parts of the country.

This was a tax-raising Budget overall, but key tax policy decisions have been deferred

Given the big spending increase the Budget contained, and that the next scheduled general election is over four years away, it is not a surprise that this Budget increased taxes overall. What is perhaps surprising is that it didn’t include even bigger tax rises.

The two largest tax rises – as expected, based on the manifesto – related to Corporation Tax and Entrepreneurs’ Relief.

Cancelling the Corporation Tax cut from 19 per cent to 17 per cent, planned for April 2020, raises a whopping £7.5 billion in 2024-25. This is a welcome change in policy, ending a run of very expensive cuts.

Reforms to Entrepreneurs’ Relief were also welcome. Effective immediately, the lifetime limit for eligible capital gains has fallen from £10 million to £1 million (a return to its original level); in turn reducing the maximum lifetime tax cut from £1 million to £100,000. This will only affect those 5,000 people a year who claim on a gain of over £1 million. However, as shown in Figure 35, although this is only 12 per cent of claimants, they account for three quarters of the current cost. The lower cap saves £1.8 billion a year by 2024-25, with estimated losses for those affected averaging £230,000 each. HMRC state that the new policy will reduce the volume of gains eligible for the relief by 58 per cent, which would lower the total projected cost of the relief to around £1 billion a year.41

It should be noted that, even without Entrepreneurs’ Relief, the maximum capital gains tax rate for shares is 20 per cent, so these 5,000 individuals a year will still pay low tax rates compared to typical employees. And although the Chancellor has cut the cost of the relief, he did nothing to target it better on innovation or entrepreneurial activities. The current beneficiaries including those setting up and then liquidating one-person service companies (having retained earnings instead of paying themselves dividends) and those selling holiday properties. More should be done in future to curtail the use of voluntary liquidations as a way to simply reclassify income as capital gains.

There were also significant changes to environmental taxes – given that this Budget was intended to “prioritise the environment” – including a substantial £1.6 billion a year raised from restricting the ‘red diesel’ fuel subsidy. In addition, the stamp duty surcharge for non-UK residents will raise some money, though its impact will be small, with the OBR estimating that only around 6,500 non-resident property purchases a year will be displaced by UK-resident ones.

This was not only a Budget of tax rises. Other taxes were cut. As promised before the election, one tax cut was an increase in the National Insurance threshold for employees and the self-employed. An annual threshold of £9,500 in 2020-21, rather than around £8,800 in the absence of a policy change, will save most employees £85 a year. However, workers in lower income households on Universal Credit will – due to the way the

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benefit’s means-testing works – lose almost two thirds of that, leaving them a net tax cut of £32 a year. Another well-trailed giveaway was a change to pension tax relief, which cut taxes for the very highest earners (who contribute to a pension) by £670 million in 2024-25. Although reform here had been linked to the coronavirus crisis – with some medical professionals arguing that working additional hours was landing them with a large tax charge – the suggested changes are permanent. HMRC notes that this change will affect an estimated 250,000 people,42 implying an average tax cut of £2,700 a year per person, with some receiving considerably more.

Other tax giveaways include freezing fuel duty yet again, at a cost of around £500 million per year, freezing alcohol duties, and setting VAT on female sanitary products and e-publications to zero. Together, these indirect tax changes will save around £30 a year per household, on average.

Taken together, as shown in Figure 36, the National Insurance change and the indirect tax cuts are a relatively progressive package across the bulk of the income distribution. The impact in the top income decile depends on the offsetting effects of the changes to pension tax relief and to Entrepreneurial Relief: the net impact is estimated to lead to a fall in average income in the top income decile, but with small groups of big winners and big losers and most people in this decile group unaffected by either measure. The losers from changes to Entrepreneurs’ Relief, as discussed, are those that need to have capital gains of at least £1 million.43

What is most striking in terms of household tax policy is simply how little has changed – coupled with the lack of change in welfare policy discussed above. An average tax cut in this Budget of around £50 a year for the poorer fifth of the population, compares to the £2,800 a year losses shown earlier in Figure 34 for tax and welfare policy as a whole since 2015.

42 HMRC, Pensions Tax Changes to income thresholds for calculating the tapered annual allowance from 6 April 2020 policy paper, March 2020
43 This figure does not include the change to Corporation Tax; it is hard to assess with certainty the long-run impact of changes to Corporation Tax on household income, but it is safe to say that not pursuing this rate cut should be a progressive tax change, in that it will affect better-off households proportionately more than low-income households, through its impacts on dividends and wages.
Beyond the taxes that most directly affect households, of course, this Budget raised taxes overall, with a net tax rise of £9 billion in 2024-25 (and £32 billion over the forecast period). In this respect, it is similar to other post-election Budgets, as Figure 37 shows. The majority of the net tax rise can be accounted for by the cancelled corporation tax cut.

Although the corporation tax change and other tax rises are sensible ones, this has not been a Budget of radical tax policy change. With the combination of a new Government, a very new Chancellor, the primacy of the coronavirus crisis, and the importance of getting reform right, a number of big tax policy choices have been left for later in the parliament:
FIGURE 37: As with previous post-election Budgets, this one was a net tax rise
Real (GDP-deflator-adjusted to 2019-20 prices) net tax policy changes (using the last year of the forecast) announced in each year

NOTES: Years containing general elections are split into before and after the election. SOURCE: RF analysis of OBR, various.

- The Treasury is to carry out a “fundamental review” of Business Rates, to be concluded at the Autumn Budget.

- A call for evidence on Vehicle Excise Duty has been launched, as “the Government believes that the VED rate should send a strong signal to individuals and businesses about which cars to buy as we transition to zero emission vehicles”.44

- Although fuel duty has now been frozen for a tenth year in a row, the Government’s stated policy – as incorporated in the fiscal forecast – remains that it will rise in line with RPI inflation in future. Rather than continue this expensive tax-rise procrastination, the Government should decide whether RPI-linking really will return from 2021; whether the freeze should continue – costing over £3 billion a year more by 2024-25; or something in between.

- Similarly, the Budget reaffirmed the Government’s “ambition” to raise the National Insurance threshold to £12,500. If this ambition were realised in 2024-25, it would cost another £6 billion in that year. As the OBR points out, without active policy change it would take until the mid-2030s for inflation to push this threshold up to £12,500 from its new level of £9,500.

- Despite rumours ahead of the Budget, there was little to be said about the country’s flawed wealth taxes: inheritance tax; pension tax reliefs (with the exception above);


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council tax; and stamp duty. These should be a focus of future policy thinking, to raise additional revenue and help remove vertical, horizontal, and geographical inequities.

Both from the perspective of improving the tax system and of boosting household incomes where needed, there may be a lot more to be done in this Parliament.

**A review of fiscal rules and frameworks means the implications for borrowing will also come later this year**

Although the 2020 Spring Budget met the fiscal objectives set out in the Conservative manifesto, the Government opted not to formally enshrine these in a revised Charter of Budget Responsibility, pending a wider review of the fiscal framework. Among other things, the review will consider the implications for fiscal policy of lower interest rates, reduced space for monetary policy, and persistent low productivity. This is very important because, while it is right to make active use of discretionary fiscal policy to support the economy through the temporary disruptions associated with coronavirus, these decisions need to be taken in the context of a credible and stable medium-term objective for the public finances. Without a credible framework, which anchors expectations for how a government will act to ensure the public finances remain sustainable, measures of the kind announced in the Budget can risks undermining confidence in the government’s approach to economic policy.

A decade on from the establishment of the Office for Budget Responsibility, whose independence the Government commits to preserve and enhance, it is sensible to reflect on the implications of changes in the economic environment and a decade of experience of using fiscal rules around the world. And doing so will give the Treasury the chance to build a wider and more durable consensus about the future direction of fiscal policy. Nonetheless, without a new framework in place, the UK is left without a fiscal anchor as policy makers address a weak economy and the risks from coronavirus.

What changes to the fiscal framework should come out of this review? As set out in our previous work, we believe the next generation of fiscal rules should:

- be anchored by an objective to improve public sector net worth to ensure governments take account of both their assets and liabilities;
- balance the current budget defined in structural terms and within a range of +/-1 per cent of GDP to allow for counter-cyclical fiscal policy and avoid disruptive fiscal fine-tuning;

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• keep net expenditure on debt interest below 6 per cent of revenue to ensure the overall debt burden remains sustainable; and

• include an ‘escape clause’ which can be triggered in exceptional times such as these when discretionary counter-cyclical fiscal policy needs to support economic activity.

The fiscal framework review includes within its scope a welcome focus on how to take full advantage of recent innovations in fiscal reporting and analysis, including the biennial Fiscal Risks Report and new data on the public sector balance sheet. The UK has been a pioneer in both of these areas, and the potential economic shock associated with coronavirus and the Government’s active use of balance sheet instruments (loans and guarantees) in its response makes a strong case for more fully integrating both of these innovations in the way we make fiscal policy. The intention to review the definition of investment within the fiscal framework is also welcome given recent progress in, for example, the measurement and accounting for intangible assets. However, if this leads to more items of public expenditure being effectively excluded from the rules, a key lesson of UK and international experience with fiscal rules over the past 20 years has been the need for them to be comprehensive in scope and based on internationally-recognised accounting concepts – failure to do this creates incentives for bad policy.47 Finally, as a country with few of our successful and widely-emulated budgeting practices (including spending reviews, multi-year budgets, and performance targets) secured in law, the willingness to consider the case for strengthening the legislative underpinning of the UK’s fiscal management system should also be considered important.

It was disappointing that a review of the monetary policy framework was not announced at the same time as that for fiscal policy. The key argument for reconsidering the fiscal rules – that the world has changed – applies with at least as much force to monetary policy. Indeed, with very low levels of interest rates constraining the room for manoeuvre of central banks the world over, it is imperative that we think hard about how to overcome these constraints as they risk a protracted period of low growth.48 Moreover, such a review is overdue: in 2013, the Treasury undertook such an exercise, promising to return to do another by the end of 2019.49 Looking ahead, then, it is important that the Government prioritises undertaking such a review.

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47 For more on what we can learn from the past use of fiscal rules, see: R Hughes, J Leslie & C Pacitti, Britannia waives the rules?, Resolution Foundation, October 2019.
Conclusion

Rishi Sunak’s first Budget as Chancellor, and the first of the new Parliament, was a big and busy one. The need to respond to the coronavirus outbreak rightly took centre stage. A broad package was offered with welcome funding for the NHS and firms, although with too little focus on supporting family incomes through the difficult months ahead. Alongside dealing with today’s crisis, this Budget sought to turn the corner on the austerity decade of the 2010s and herald a new era for the Conservative party’s approach to managing the public finances. This wider increase in spending dwarfed the coronavirus response, providing the framework for the Spending Review due later this year. The Spending Review envelope implies that while austerity will not only have been ended but put into reverse on the capital side, all will not be plain sailing for day-to-day public services over the next few years, with the majority of austerity for unprotected departments still in place. In both areas, big trade-offs will still need to be made. And for families, in contrast with very significant increases in spending on infrastructure and public services, this Government will instead continue to roll out welfare cuts that risk child poverty rising close to record highs.

Compared to the increases in spending, there were only modest changes in taxation, partially offset by smaller tax cuts. Progress on more substantial reforms to wealth taxes and others was not made. With only limited tax increases, the Chancellor has therefore significantly increased borrowing to allow the spending increases to happen. The Government’s objective is now to increase spending as much as possible without losing control of the public finances, rather than policy delivering lower borrowing and falling debt levels. Rishi Sunak has set the country on course for both higher borrowing and higher debt, but without much sense of where that might end up. A review of the fiscal framework later this year is therefore welcome.

The Chancellor’s Budget debut has been well-received, but there aren’t many easier Budgets than those that dole out lots of cash and don’t ask anyone to pay the full bill. Tougher decisions lie ahead.
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