Resolution Foundation
BRIEFING

Spending fast, taxing slow

Resolution Foundation analysis of Budget 2021

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Summary

This was a much bigger Budget than expected, both in terms of giveaways and takeaways. A welcome £67 billion increase in fiscal support for the economy in the next two years was combined with plans for the largest tax increases since 1993. In both cases British firms were in the frontline to a quite staggering extent.

Most immediately, the Chancellor has rightly extended short-term crisis support not only up to, but also beyond, the planned end of public health restrictions this summer. Continuing furlough to September will reduce the rise in unemployment ahead, with the Office for Budget Responsibility (OBR) expecting it to peak at just 6.5 per cent (down from 7.5 per cent). If realised, this would be by far the lowest unemployment peak in any recent recession, despite this being the deepest downturn for 300 years.

Alongside the Coronavirus Job Retention Scheme (JRS), the extension of the Self-Employment Income Support Scheme (SEISS) to those who filed a 2019-20 tax return is right on fairness grounds, but will still leave two-thirds of self-employed workers excluded to date without support. Continuing the £20 a week uplift to Universal Credit (UC) for another six months will raise the incomes of the poorest households by more than 3 per cent in 2021-22, but with the cliff-edge for support being withdrawn delayed rather than removed.

Together with more grants for hard-hit firms, these extensions mean overall crisis spending will now total over £340 billion, or £12,400 per UK household. As a result, borrowing will hit £234 billion in 2021-22, £70 billion more than previously thought. The forecast period ends, though, with borrowing returning to 'normal levels' of under 3 per cent of GDP (£28 billion lower than forecast in November), reflecting a substantial fiscal consolidation. Debt peaks at 110 per cent of GDP in 2023-24, declining thereafter. The lasting fiscal impact of the pandemic is an increase of debt of around 25 per cent of GDP, although not higher debt interest costs.

The provision of significantly more fiscal support and the successful vaccine programme mean the OBR thinks that a stronger recovery than previously expected lies ahead, with economic output exceeding its pre-crisis peak in the second quarter of 2022, rather than at year end, as expected in November.

The Chancellor sought to boost this recovery once restrictions are lifted by giving firms a large incentive to invest in plant and machinery with an unprecedented £24 billion 'super deduction' tax incentive. The goal is a good one: to unlock some of the £118 billion corporate cash pile built up during the pandemic to address the UK's terrible recent investment record. This very significant policy will boost investment over the next two

years although its temporary nature means it will do nothing about the UK's long-lasting investment weakness.

The good news for firms investing in plant and machinery soon, was matched by bad news for any of them intending to make profits in future. The Chancellor announced tax rises totalling £29 billion by the middle of this decade, with a full £17 billion of that coming from a big rise in Corporation Tax to 25 per cent (from 19 per cent currently). Although companies making low levels of profits will be protected, this is by far the largest change to Corporation Tax revenues since the 1970s and the first rise in the main rate of Corporation Tax since 1973. This announcement marks not only an abrupt U-turn on a decade of Conservative Chancellors prioritising lower corporation tax, but a big departure for the traditionally low tax party: it takes the overall tax take as a share of GDP to levels not seen since the late 1960s. In the long-run, the OBR concludes this rise will likely reduce business investment.

For other tax rises, the Chancellor turned to the least-visible options, freezing thresholds for a whole swathe of taxes from inheritance tax to VAT. Most significant of these is an £8 billion revenue raiser from freezing the Income Tax personal allowance and higher-rate threshold at their April 2021 levels for four years. This is a reasonable choice, leaving the point at which you start paying tax still more than 50 per cent above its 2010-11 level. The majority of the revenues will come from the richest households, with the top fifth of households paying £720 per year more on average – twelve times that of the bottom 20 per cent of households (£60).

So the big picture is more support in the next few years and then tax rises later in the decade. That's the right approach, but the Chancellor is taking some big risks.

First, his focus on firms means he has far less to say about supporting households in the recovery. His judgement is that, with many (higher-income) families having built up savings during this crisis, consumption will bounce back swiftly. That is almost certainly true in sectors that have been shut down like hospitality, but it is less certain across the economy as a whole. With unemployment rising in the Autumn, and the Chancellor deciding to end the £20 uplift to UC at exactly that point, it will not feel like a recovery for millions of households. That latter policy will leave the basic level of benefits at its lowest level since the early 1990s and the poorest households facing a 7 per cent fall in income in the second half of 2021-22.

OBR forecasts support this, with household incomes falling next year by 0.4 per cent even as GDP rises. Looking at this Parliament as a whole, incomes are forecast to grow by just 0.3 per cent a year on average, the weakest parliament for living standards outside the short 2015-2017 parliament (when the income fall was driven by the post-referendum inflation spike). Earnings, meanwhile, are set to be 4.3 per cent lower by the middle of the decade in real terms (equivalent to £1,200 per year) compared to pre-crisis forecasts.

Second, public services will be under pressure. While plans for the highest level of investment spending since the 1970s were maintained, day to day public service spending is in for a tougher ride. Not only has the Treasury rather optimistically assumed that there is no long-lasting increase in public service spending as a result of this crisis even in the likes of social care, they have actually reduced such spending by £4 billion a year compared to previous plans. Without this additional cut being pencilled in the Chancellor would not have been able to say that debt is falling and the current budget in balance. Coming on top of a £12 billion cut in the Autumn Spending Review, this would mean day-to-day public service spending for unprotected departments (such as transport and local government) falling by £2.6 billion next year (2022-23). By 2024-25, day to day public service spending per capita in unprotected departments will still be almost one-quarter lower than in 2009-10. For those public services it will feel very much like George Osborne is still the Chancellor.

Third, such a large tax revenue increase may not turn up. The Chancellor will be under significant pressure to soften the blow for business in the years ahead, not least from some Conservative MPs who will argue that he has wrongly prioritised the Conservative Party's reputation for caring about the public finances over their attachment to low taxes. Whether that decision will stand the test of time remains to be seen. The Chancellor may be hoping that some of these large tax rises can be watered down later on, but it is just as likely that more will be required.

This was a big, policy focused, Budget. It rightly sought to boost the recovery before turning to fixing the public finances, in both cases with a large (potentially too large) focus on Britain's firms. Further big questions await the Chancellor on protecting household incomes, managing the squeeze on some public services, and whatever else we discover the highly uncertain path out of this pandemic has in store.

The big picture on the economy is little changed, but a successful vaccine rollout and more stimulus leaves hope for a faster-than-expected recovery

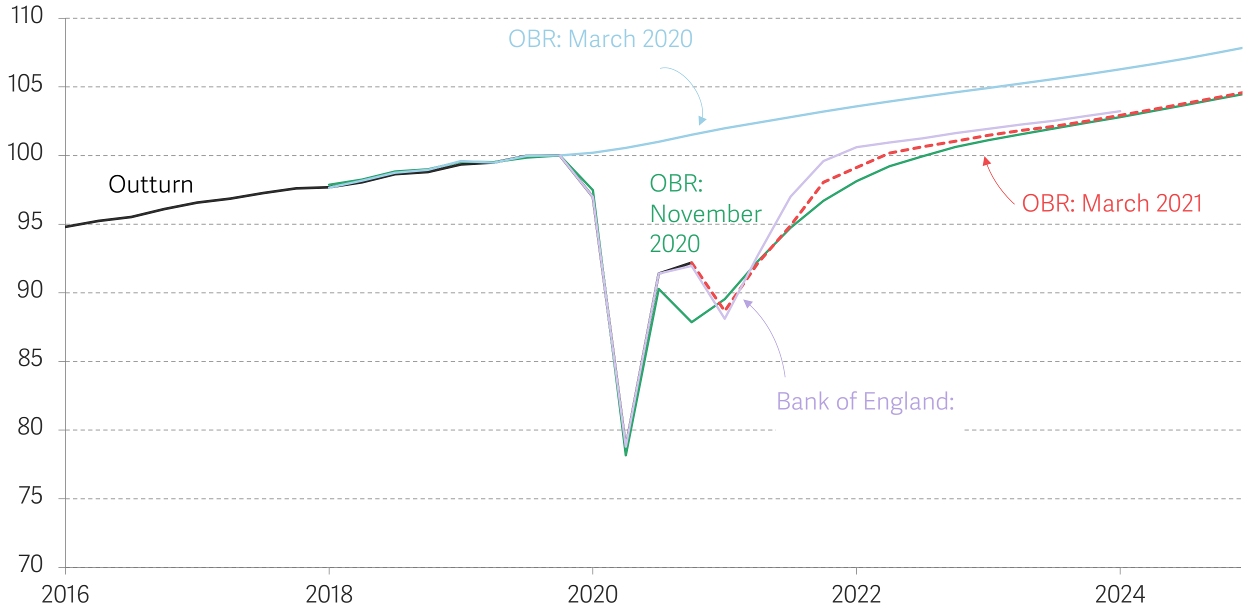
The state of the economy is the fundamental driver of the policy decisions that have been taken at this Budget. The ongoing health crisis means that economic activity currently remains well below pre-crisis. However, the successful vaccine rollout, gradual easing of restrictions and further extensions of fiscal support mean the OBR now expects to see a relatively swift recovery and less long-term damage than seen after most recessions.

A weaker start to 2021 is forecast to be followed by a stronger recovery

The OBR's economic forecast has changed remarkably little since November 2020 (see Figure 1). An improvement in the amount of economic activity that can be sustained for a given level of social distancing restrictions, combined with upward revisions to GDP outturns by the ONS, has meant that the OBR's expectation for GDP in Q1 2021 is barely changed at 11 per cent below its pre-crisis level, despite another national lockdown since Christmas.[1]

FIGURE 1: **The path of the recovery has been lumpier than the OBR expected last year**

Selected GDP projections (Index, 2019 Q4 = 100): UK



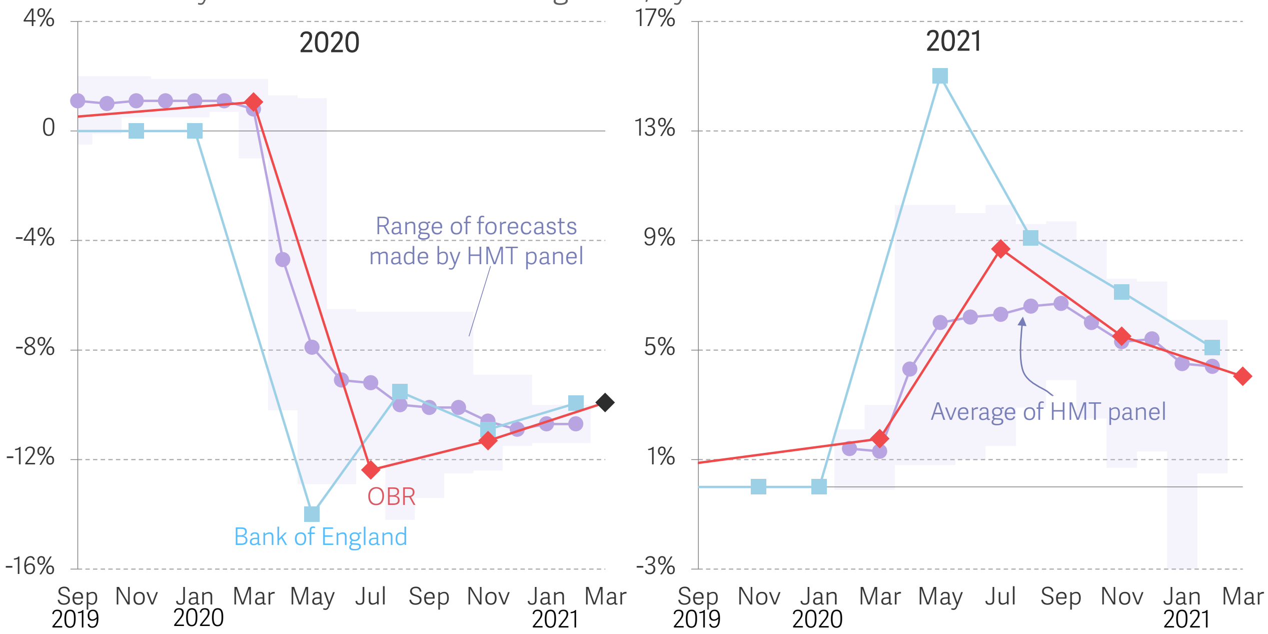
NOTES: OBR forecasts refer to the central scenario.
SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, various; ONS, National Accounts; Bank of England, Monetary Policy Report, various.

Further fiscal support and a swifter-than-expected vaccine rollout mean the OBR expects a faster recovery later in 2021. GDP growth in the second half of this year is projected to be materially higher, meaning that economic output will exceed the pre-crisis peak in Q2 2022, rather than taking until Q4 2022, as expected in November. In previous forecasts, the OBR was somewhat more pessimistic than average in forecasting the level of GDP during the recovery, but the OBR is now broadly in line with the average of other UK forecasters, albeit still slightly below the Bank of England's expectations (Figure 2).

1 See J Leslie et al., How to throw good money after good: Budget 2021 and the challenge of delivering a rapid recovery from Covid-19, Resolution Foundation, February 2021.

FIGURE 2: **The OBR is now more optimistic than other forecasters about the pace of recovery**

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



SOURCE: RF analysis of HM Treasury; Bank of England; and OBR.

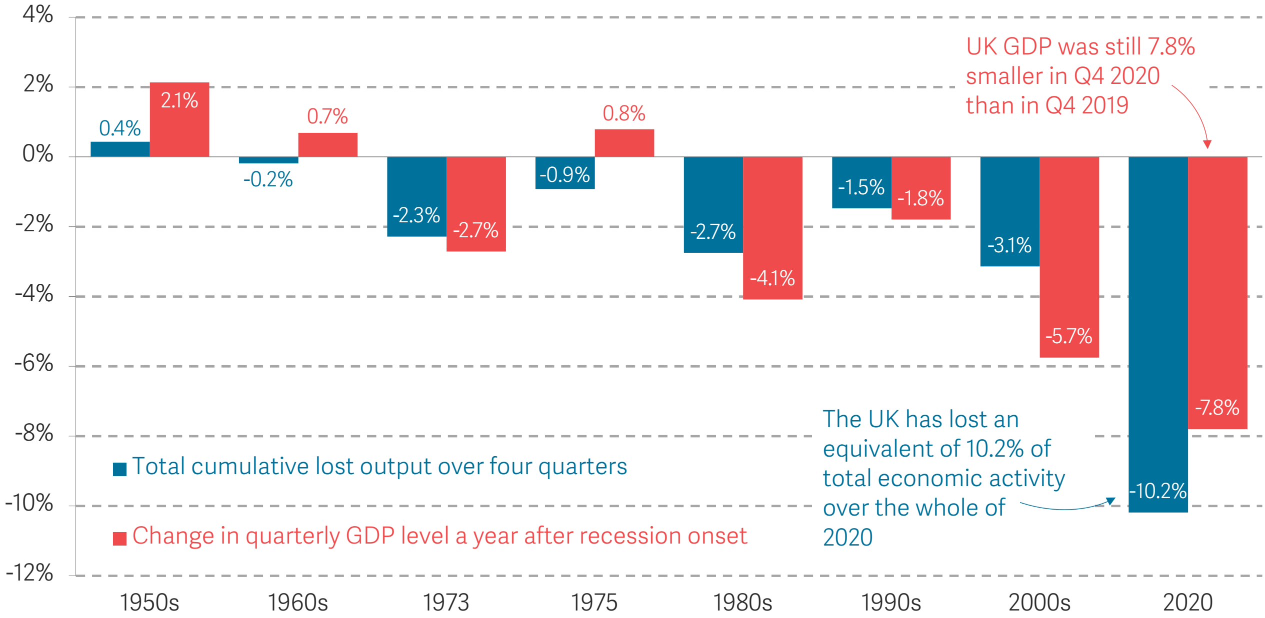
But there remains substantial uncertainty in the economic outlook, reflected by the fact that the OBR has stood by its 'upside' and 'downside' scenarios, representing the range of plausible outcomes.[2] Chief amongst those is the path of the pandemic itself, the emergence of further variants of the virus and the lasting effectiveness of vaccines. These issues will affect the UK directly but also via their impact on the global economy.

The fact that economic activity is currently far below pre-crisis levels (Figure 3), driving the need for extended crisis support schemes, is just one part of the picture. What matters for longer-term fiscal sustainability, and ultimately the living standards families can expect to have in the future, is the lasting economic damage from this crisis. The OBR did not change their expectation for long-term economic scarring of 3 per cent of GDP. Two-thirds of this comes from lower productivity, particularly a lower capital stock from foregone business investment and lower total factor productivity. And the final third comes from the labour market mostly as a result of lower participation (for example due to older workers retiring earlier than expected).

2 In the downside scenario, the economy is not expected to reach its pre-crisis peak until the end of 2024, while in the upside scenario it exceeds that peak in Q3 2021.

FIGURE 3: **Lost output over the past year is three times greater than the financial crisis**

Cumulative lost economic output over four quarters after the start of subsequent recessions, and the fall in GDP level one year after the start of the same recessions: UK

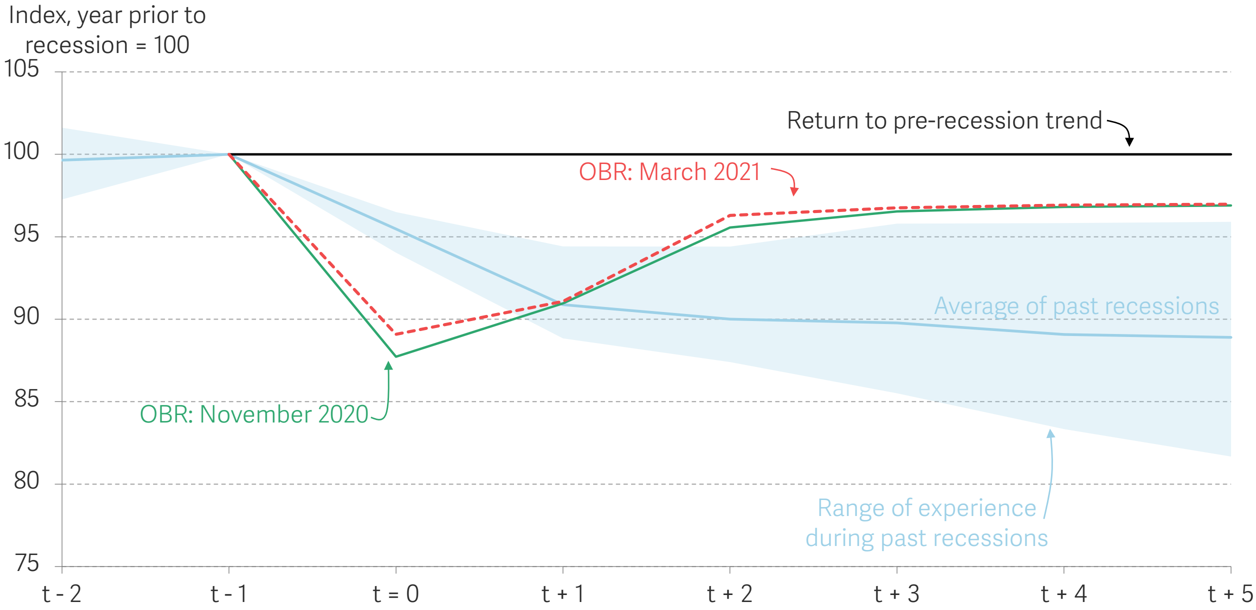


NOTES: Changes in GDP are measured relative to the quarter prior to the first quarterly fall in GDP. Recessions are defined as two or more consecutive quarters of negative GDP growth. GDP is based on chained volume measure and so are in real terms.
SOURCE: RF analysis of ONS, GDP first quarterly estimate time series (ABMI).

Figure 4 puts this long-term scarring into historical perspective. Five years after a recession, the level of GDP in the UK has, on average, been over 10 percentage points below its pre-recession trend. Scarring of 'just' 3 per cent would, therefore, be remarkably small, and especially so given the scale of the fall in economic activity during this crisis. But there are good reasons to think scarring may be smaller than 'normal' following this crisis. For example: the scale of direct fiscal support has been unprecedented and has protected many households and businesses from the economic shock; in aggregate, households have higher savings now than pre-crisis, meaning there may be less of a desire to build up precautionary savings that we usually see after recessions; the financial sector has remained well-functioning, meaning access to credit for households and businesses should continue; and the crisis is expected to have a relatively short duration. Importantly, the OBR judges that the long-term scarring from this crisis will be smaller than the effects of Brexit: now the details of the trade deal are known, the OBR has judged that the long-term effect of leaving the EU will be to shrink the UK economy by 4 per cent.

FIGURE 4: **The OBR is now assuming that economic scarring will be limited compared with past recessions**

The level of real GDP relative to pre-recession trend during past recessions (Index, year prior to recession = 100): UK



NOTES: t = 0 is the year of the recession (first year that GDP growth is negative); swathe includes 1970s, 1980s, 1990s and financial crisis recessions. In the shaded area, 'trend' is estimated to be the average growth rate over five years, five years prior to the start of the recession.
SOURCES: RF analysis of ONS, National Accounts; OBR, Economic and Fiscal Outlook, various.

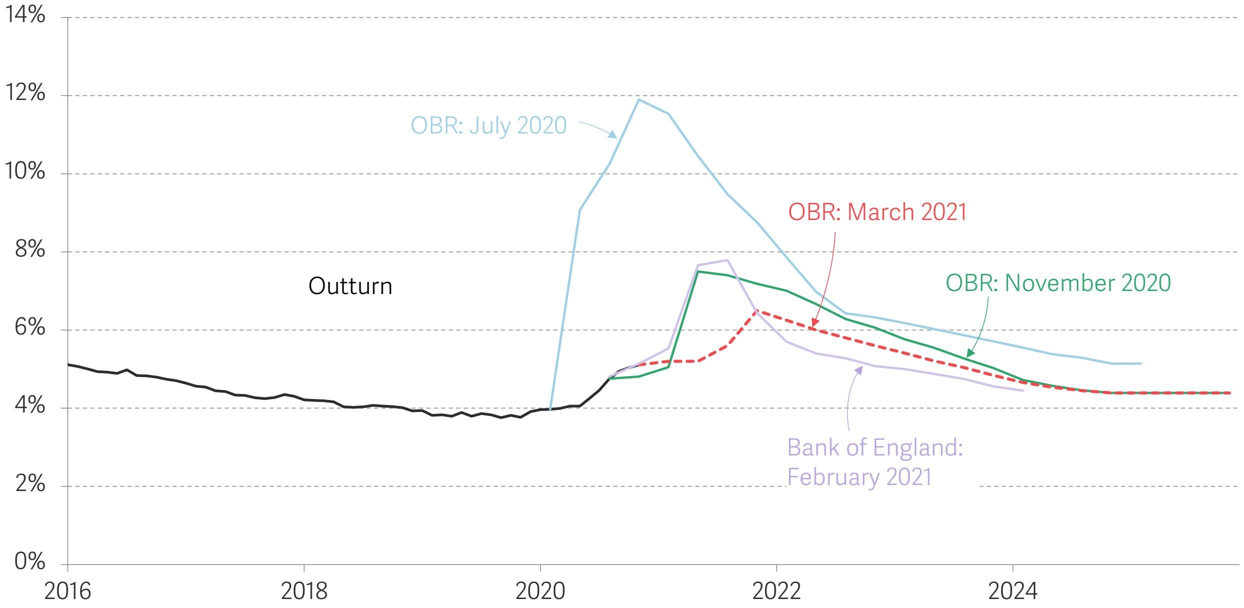
Despite a recovery in economic output, unemployment will rise in 2021, although the outlook is improved thanks to the extension of the Job Retention Scheme

Despite an overall economic bounce back in 2021, employment will get worse this year, not better. Withdrawing the Coronavirus Job Retention Scheme (JRS) at a time when the economy will still be operating below previous levels of output inevitably means higher unemployment, which the JRS scheme has largely prevented until now. As we discuss later, the Government now plans to withdraw the JRS in September 2021 when the OBR expect output at this point to be 2 per cent below its pre-crisis peak, resulting in the unemployment rate rising to 6.5 per cent in 2020 Q4 (corresponding to the number of unemployed reaching 2.2 million). This is a later and lower peak of unemployment than the 7.5 per cent in Q2 2021 previously expected (see Figure 5). This is because the Government's previous JRS plans were to withdraw the scheme in April, at a point when GDP is expected to be 8 per cent below pre-crisis levels.

A peak unemployment rate of 6.5 per cent would be lower than in any recent recession periods – almost half the rate seen in the early 1980s, for example (see Figure 6). The actual rise in unemployment ahead of us is very uncertain, but, if it does transpire, then such a low peak would be extraordinary given the scale of the economic shock we have faced. This underlines, again, the importance of the furlough scheme.

FIGURE 5: **Unemployment is set to peak at a lower rate than forecast in November**

16+ unemployment rate, outturn and various forecasts: UK



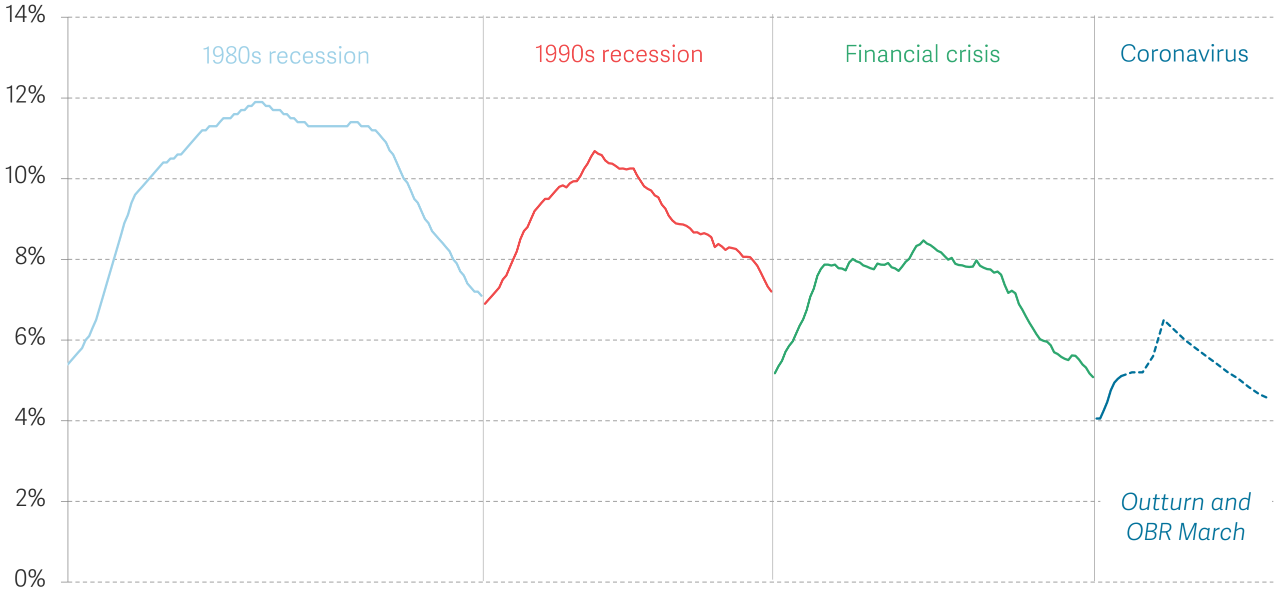
SOURCES: RF analysis of ONS, Labour Market Statistics; OBR, Economic and Fiscal Outlook, various; Bank of England, Monetary Policy Report, various.

While the near-term outlook is improved, the longer-term picture is unchanged. The OBR still expects the unemployment rate to settle at a higher point (4.4 per cent) than pre-crisis (3.9 per cent) and that this new normal will not be reached until the end of 2024. This rate of recovery in unemployment (roughly –0.2 percentage points in the unemployment rate per quarter) is in line with what has happened in previous recoveries, although the assumption that unemployment will start falling immediately after reaching its peak appears somewhat optimistic when compared to previous crises (for example, unemployment remained near its peak for around three years following the financial crisis: see Figure 6).

The picture on earnings is also essentially unchanged on the previous forecast (see Figure 7). Leaving aside short-term earnings changes (which are heavily affected by compositional factors), the lasting impact of this crisis is that real earnings are expected to be 4.3 per cent below where they were forecast to be pre-crisis, equating to £1,200 per year (in 2020 prices). This is partly a result of a permanent hit to productivity, with output per hour expected to be 2.1 per cent lower in 2025 than the pre-crisis forecast, and partly down to a smaller labour share of income. This markdown in the earnings outlook comes on the back of a truly dreadful past decade for earnings growth.

FIGURE 6: **Unemployment will peak at a lower point than in any recent recession period**

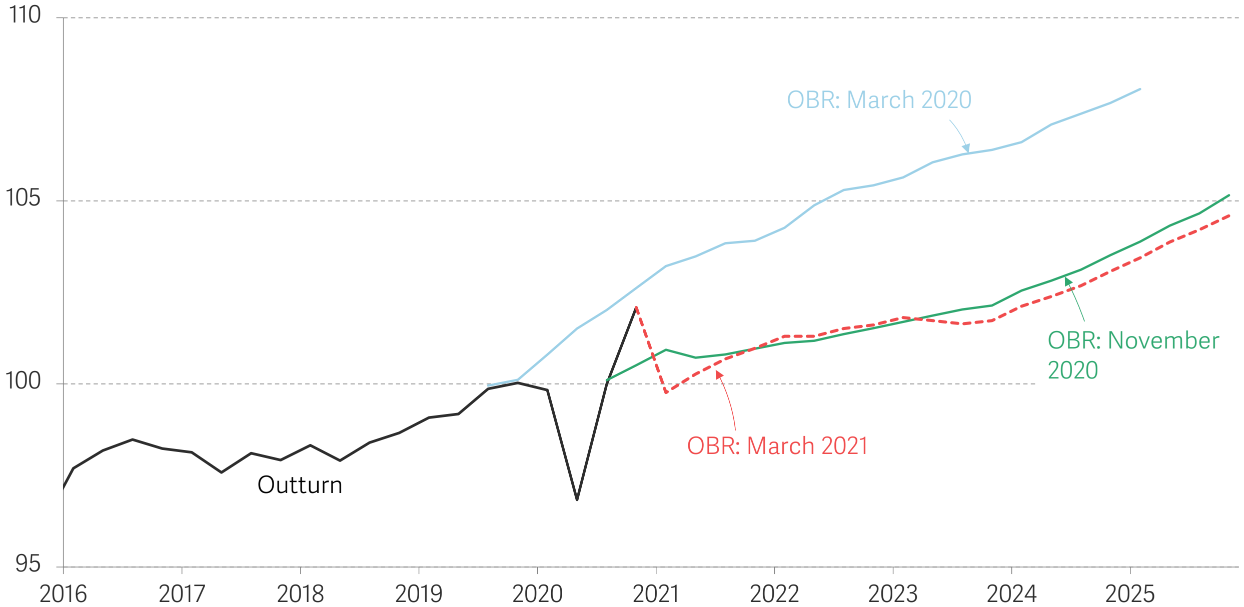
16+ unemployment rate in previous recessions, and outturn and OBR March 2021 forecast for coronavirus crisis: UK



SOURCES: RF analysis of ONS, Labour Market Statistics; OBR, Economic and Fiscal Outlook, March 2021.

FIGURE 7: **The outlook for pay is unchanged on November, and real earnings are expected to be 4.3 per cent below the OBR's pre-crisis forecast by 2025**

Average employee earnings, adjusted for growth in CPI inflation (Index, 2019 Q4 = 100): UK

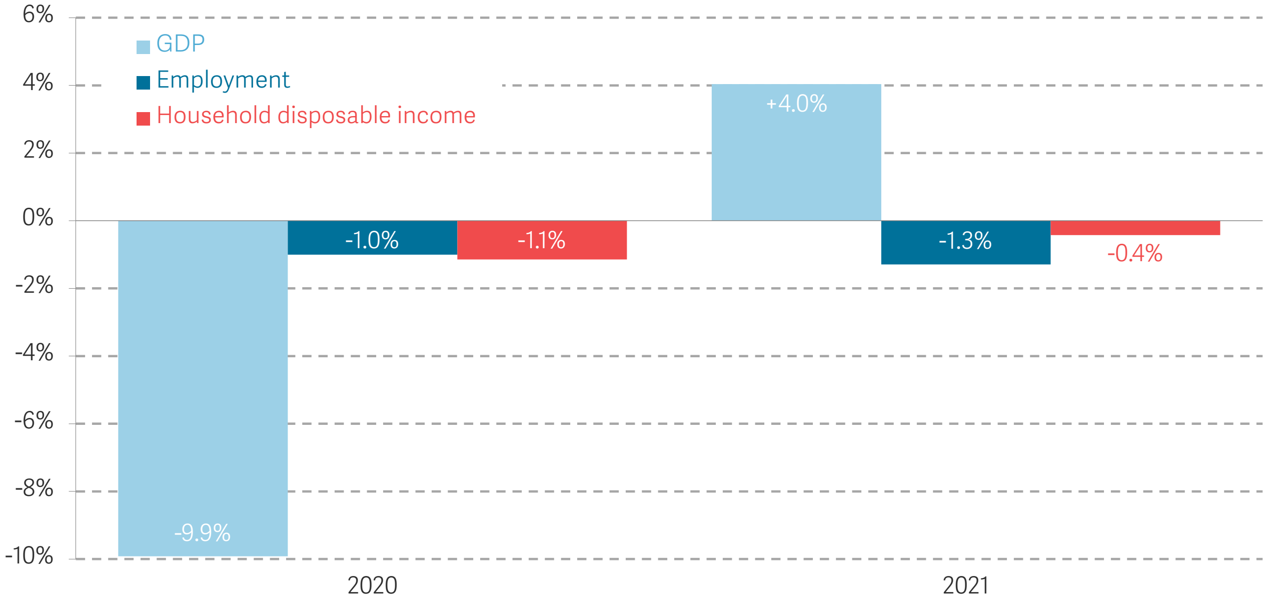


SOURCES: RF analysis of OBR, Economic and Fiscal Outlook, various; Bank of England, Monetary Policy Report, February 2021.

2021 will not be a good year for household incomes despite the GDP recovery, as Figure 8 shows. Rising unemployment and the withdrawal of support later in the year means that the trough of this downturn when it comes to household incomes is ahead of us, rather than behind. The OBR expects real average household disposable incomes to fall by 0.4 per cent in 2021, coming on top of the 1.1 per cent fall in 2020. And, as set out above, the fall in employment is greater this year (-1.3 per cent) than last year (-1.0 per cent).

FIGURE 8: **Despite the economy recovering in 2021, it will be a worse year for employment than 2020, and income growth will be weak**

Annual growth in real GDP, employment, and real household disposable income, in calendar years 2020 and 2021: UK



SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, March 2021.

These weak living standards outcomes are grim, but they are especially so coming at the end of a long period of stagnant income growth.[3] Real per capita income growth in the twelve years from the onset of the financial crisis to immediately before the pandemic was just 4 per cent; in the twelve years leading up to the financial crisis, it was 32 per cent. And these averages also hide what has been a defining feature of the crisis – its unequal impacts. Low-paid workers have been much more likely than higher-paid workers to have lost their job, been furloughed or to have lost earnings over the past

3 M Brewer et al., The Living Standards Outlook 2021, Resolution Foundation, January 2021.

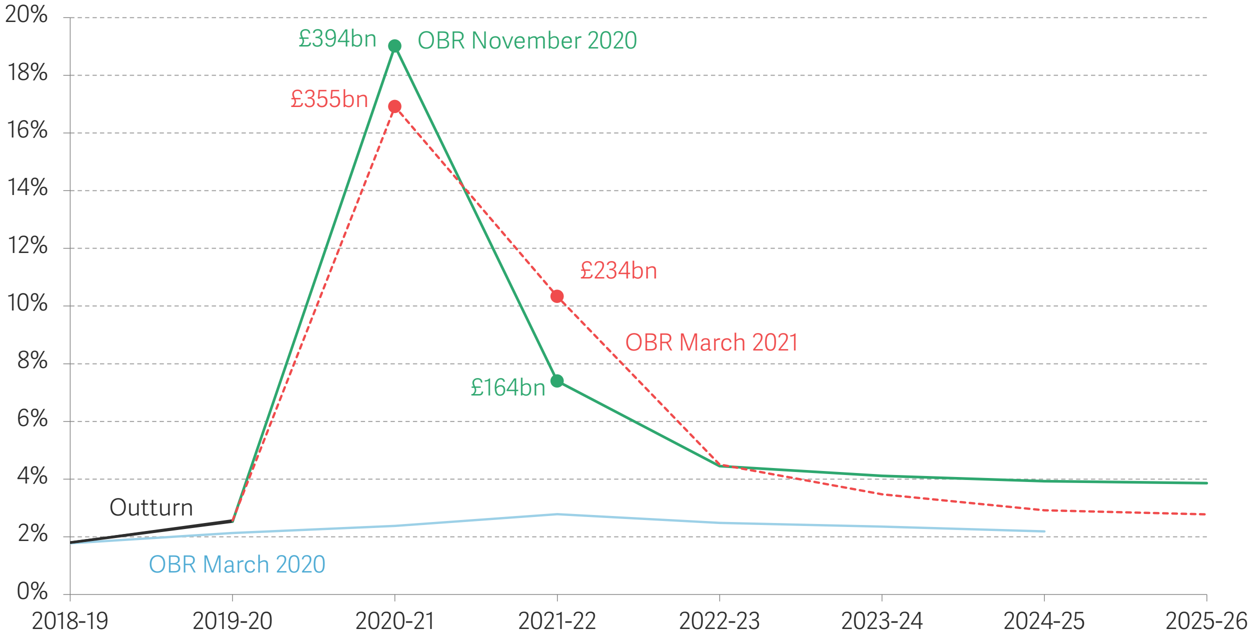
year.[4] Low-income households are also more likely than higher-income households to have experienced a deterioration in their financial position, with many facing both higher costs and falling incomes.[5]

Policy choices dominate changes to the fiscal forecasts

The other key context to the Chancellor's policy decisions is the state of the public finances. These reflect the revisions to the economic forecasts above, but changes to the forecast since the November 2020 Spending Review are largely driven by policy decisions. In 2020-21 borrowing is now set to total £355 billion, a £39 billion reduction on the £394 billion forecast back in November as shown in Figure 9. In contrast, the renewed lockdown and the associated extension of emergency support schemes (discussed below) mean borrowing is elevated next year, totalling £234 billion in 2021-22, compared to the £164 billion forecast at the Spending Review. The forecast ends with borrowing returning to 'normal levels' of under 3 per cent of GDP (£28 billion lower than forecast in November), reflecting the substantial fiscal consolidation announced in this Budget (see Figure 9).

FIGURE 9: **Borrowing is set to be £39 billion lower in 2020-21, but £70 billion higher in 2021-22, than forecast in November**

Public sector net borrowing as a proportion of GDP, outturn and successive forecasts: UK, 2018-19 to 2025-26



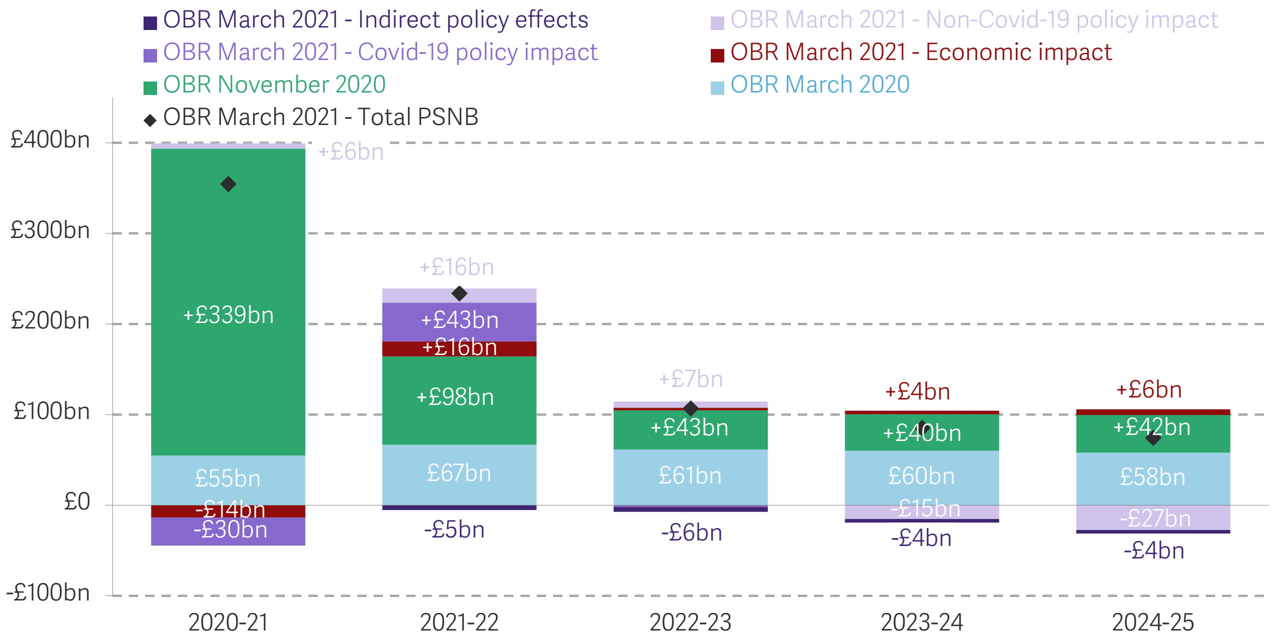
SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, March 2020, November 2020 and March 2021.

4 N Cominetti et al., Long Covid in the labour market: The impact on the labour market of Covid-19 a year into the crisis, and how to secure a strong recovery, Resolution Foundation, February 2021.
5 M Brewer & R Patrick, Pandemic pressures: Why families on a low income are spending more during Covid-19, Resolution Foundation, January 2011.

As illustrated in the purple bars in Figure 10, the fluctuation of the borrowing forecasts over the past year primarily reflects the difficulties of costing rapidly-changing Covid-19-related policy responses. 2020-21 saw the largest upwards revision to borrowing between fiscal forecasts in the OBR's history at the Spending Review, as borrowing jumped by 17 per cent of GDP, rocketing from the £55 billion forecast in March 2020 for 2020-2, to £394 billion. But this has now been followed by a two per cent (£39 billion) cut in borrowing forecasts for 2020-21 between November 2020 and this Budget: the largest downward revision one year into a forecast on record.[6]

FIGURE 10: **The fall in borrowing reflects Covid-related uncertainty in the near-term, and policy decisions reducing borrowing in the medium-term**

Public sector net borrowing in £ billion, March 2020 forecast and additional borrowing forecast in November 2020 and March 2021: UK, 2020-21 to 2024-25



SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, March 2021.

In 2021-22, the effects of continuing Covid-19-related restrictions increase borrowing by £59 billion, via both the impact on the economy and associated extension of support schemes (the dark red and purple bars in Figure 10). However, borrowing is also elevated by a further £16 billion of 'stimulus' spending announced at the Budget, principally the temporary investment allowance tax breaks, discussed in more detail below.

Looking over the medium-term, an increase in debt interest spending (detailed below), as well as additional welfare spending, increases borrowing by £6 billion in 2024-25, compared to the November forecast (shown in the dark red bars in Figure 10). This stems

6 RF analysis of the OBR's Historical official forecast database, which allows the comparison of forecasts of public sector net borrowing as a proportion of GDP from fiscal events since March 1977.

from an assumption of permanently-higher caseloads for Universal Credit and legacy benefits by the end of the forecast, following from the unemployment forecasts set out above.

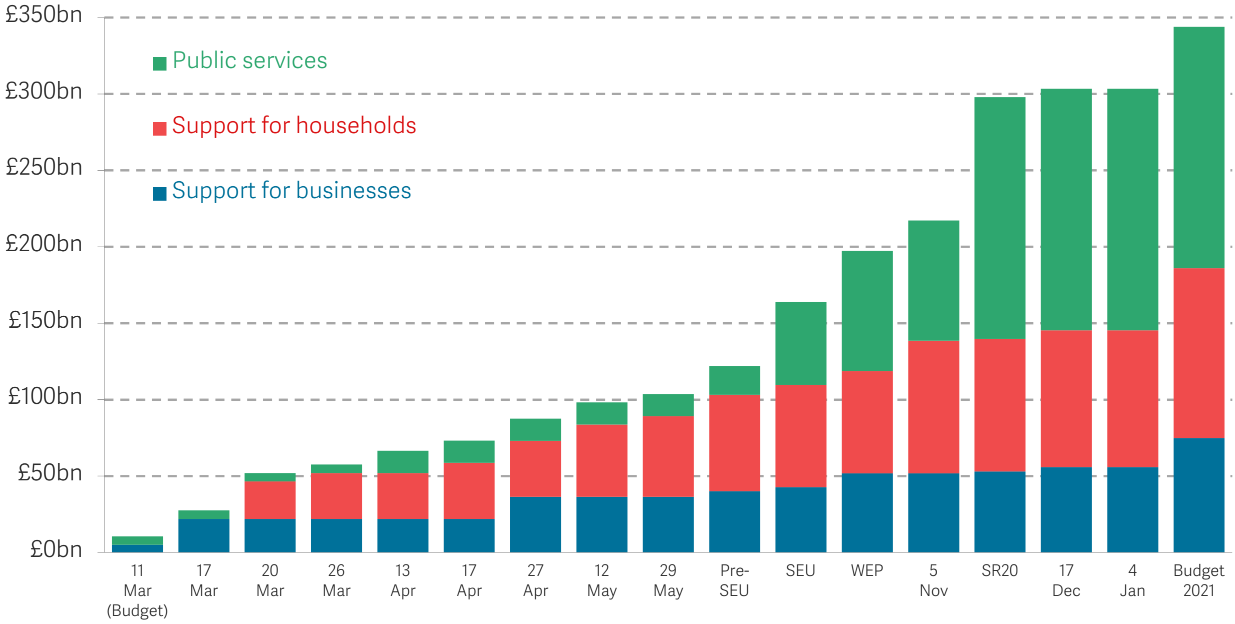
In response, the Chancellor has put in place a very substantial tax-led fiscal consolidation in this Budget. The lighter purple bars in Figure 10 illustrate that these represent a £27 billion consolidation by 2024-25, discussed in more detail below.

Spending will remain at wartime levels for a further year, but taxes are permanently rising to levels not seen since the 1960s

Pandemic-related government spending has reached a peacetime record this year (54.4 per cent of GDP) – because of both the public health response and the additional economic support – and is set to remain elevated in 2021-22, reflecting the decision to continue spending on support for public services, firms and households (which we discuss below).

FIGURE 11: **Total Covid-19 crisis spending now stands at over £340 billion**

Cumulative cost of the Covid-19 pandemic policy response, by economic support category: UK, March 2020 to March 2021



NOTES: 11 March (Budget) figures based on announcements made by Chancellor in SB20. Other costs based on outturn and OBR March 2021 forecast estimates.
SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, March 2021.

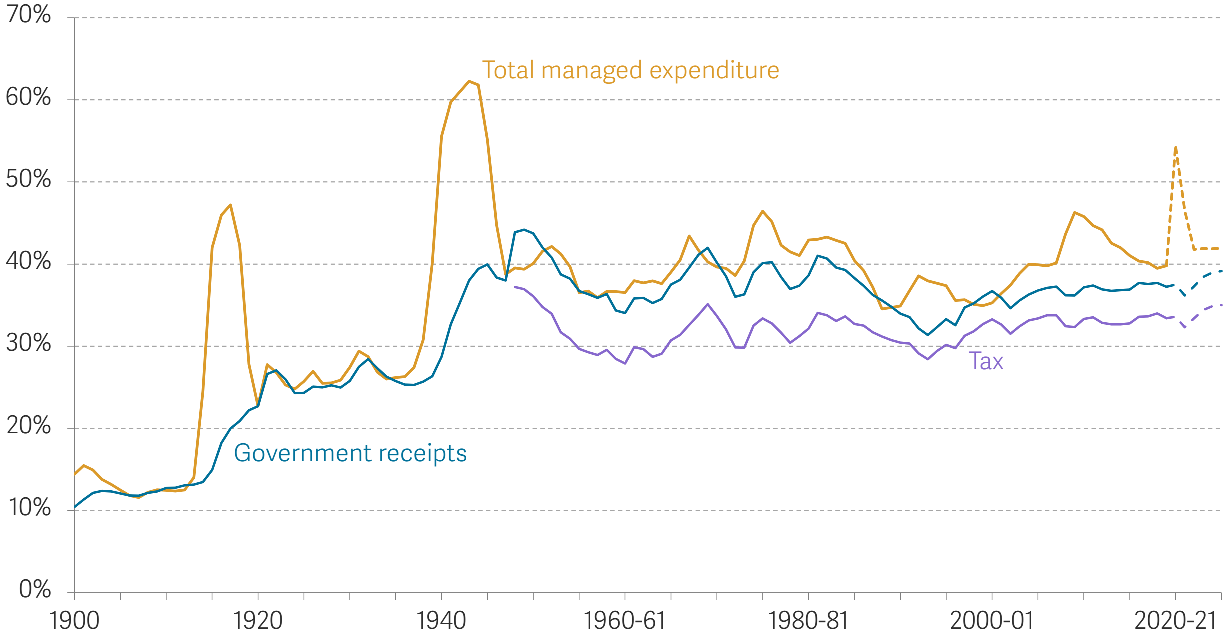
These new announcements take total crisis spending to over £340 billion (see Figure 11), equivalent to £12,400 per UK household. This includes support for households such as extending the JRS and Self-Employment Income Support Scheme (SEISS) until the end of September 2021, taking their cumulative spend to £107 billion; the extension of the £20 a week Universal Credit uplift, also now set to end in September 2021; and a series of business support measures. Indeed, the past 12 months have seen 17 coronavirus-related policy announcements, any one of which would have been deemed substantial in normal times.

Figure 12 shows that only in wartime have we seen government largesse of this scale. But the OBR expects spending to fall rapidly, reaching 41.8 per cent of GDP by 2022-23. This is 2 per cent higher as a share of the economy than we saw pre-crisis. This partly reflects the permanently lower level of GDP that mean that, although forecasts for spending as a share of GDP have increased since March 2020, spending itself has not. For example, cash TME in 2024-25 was forecast a year ago to be £1,080 billion, but it is now forecast to be £1,069 billion. It also reflects significant increases in capital and health spending in recent years.

And while spending is set to be falling from its crisis highs, tax will rise in the years ahead. The major tax rises in this Budget are forecast to increase government tax receipts to 35 per cent of GDP in 2025-26, the highest level since 1969.

FIGURE 12: **Tax levels are on course to hit heights not seen since 1969**

Total managed expenditure (TME) and government receipts as a proportion of GDP: UK, 1900 to 2025-26



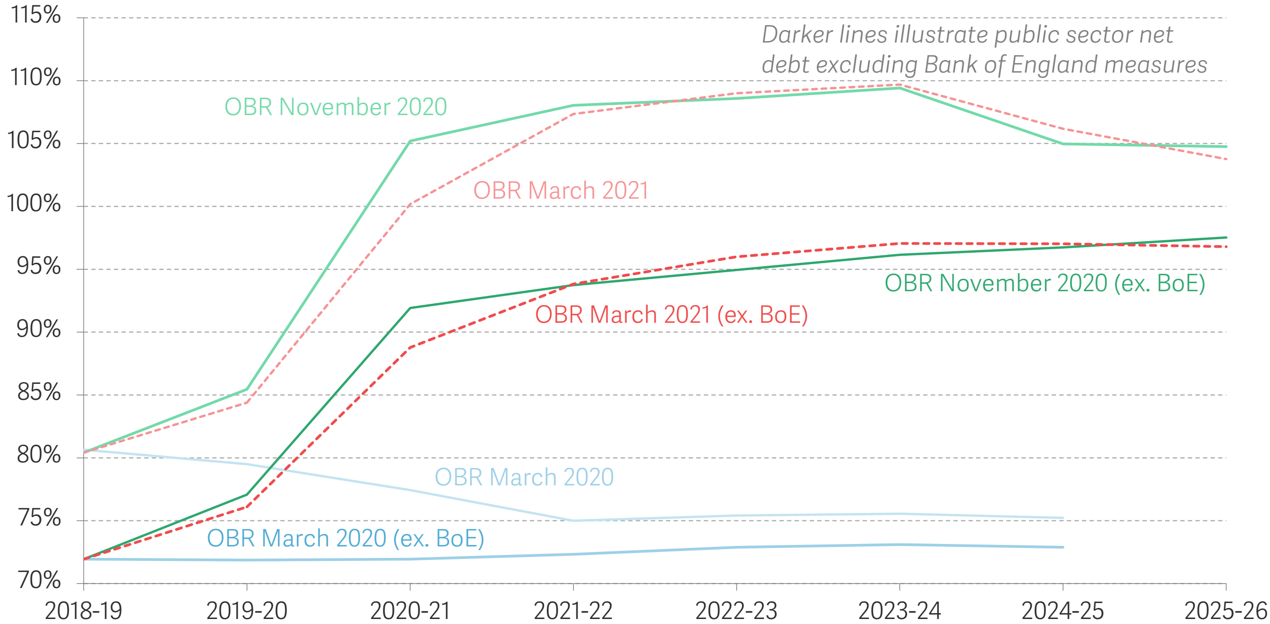
SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, March 2021 & various; Bank of England, A millennium of macroeconomic data for the UK.

Overall, the public finances currently remain sustainable over the medium term

Given the historic increases in borrowing this year and next, debt is set to reach levels unseen since the late 1950s, peaking at nearly 110 per cent of GDP in 2023-24. The lasting fiscal impact of the pandemic is therefore an increase of debt of around 25 per cent of GDP. However, the tax rises and spending cuts announced by the Chancellor in this Budget (which we discuss in more depth later) significantly change the path of debt in the later years of the forecast, flattening the rising trajectory of underlying debt. This is shown in Figure 13, which illustrates the path of public sector net debt, both including and excluding Bank of England measures. (The latter is a better measure of fiscal sustainability, as it abstracts from the effect on the public sector balance sheet of the Bank's Term Funding Scheme. The unwinding of this loan scheme is forecast to reduce debt by £85 billion in 2024-25, and a further £50 billion in 2025-26 – but has no real bearing on fiscal sustainability). In contrast to the November forecast, public sector net debt excluding the Bank of England measures is falling by the end of the forecast, by £0.7 billion in 2024-25 and £4.1 billion in 2025-26.

FIGURE 13: **Tax rises mean underlying debt is projected to be stable by the end of the forecast**

Public sector net debt as a proportion of GDP, including and excluding Bank of England measures, outturn and successive forecasts: UK, 2018-19 to 2025-26

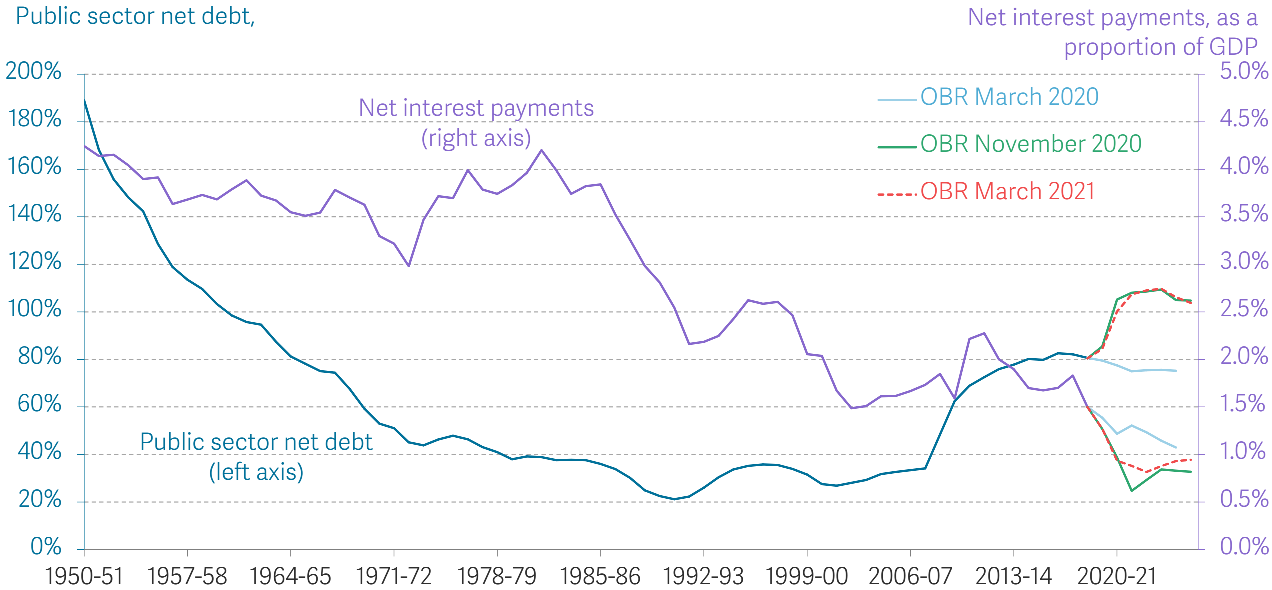


SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, March 2020, November 2020 and March 2021.

Similar to previous forecasts, although the debt stock remains high in historical terms, the overall picture is currently one of manageable pressure on the public finances, with debt interest costs at historic lows: they remain at their lowest level in over a century, and have actually fallen over the past year (Figure 14). This is largely due to even-lower interest rates and inflation than forecast pre-pandemic, as well as the effects of a near-doubling of the Bank of England's quantitative easing programme over the past year, which effectively refinances large portions of the government's debt at Bank Rate, currently 0.1 per cent.

FIGURE 14: **Despite rising debt, debt interest payments remain at historic lows**

Public sector net debt and net interest payments as a proportion of GDP, outturn and successive forecasts: UK, 1950-51 to 2025-26



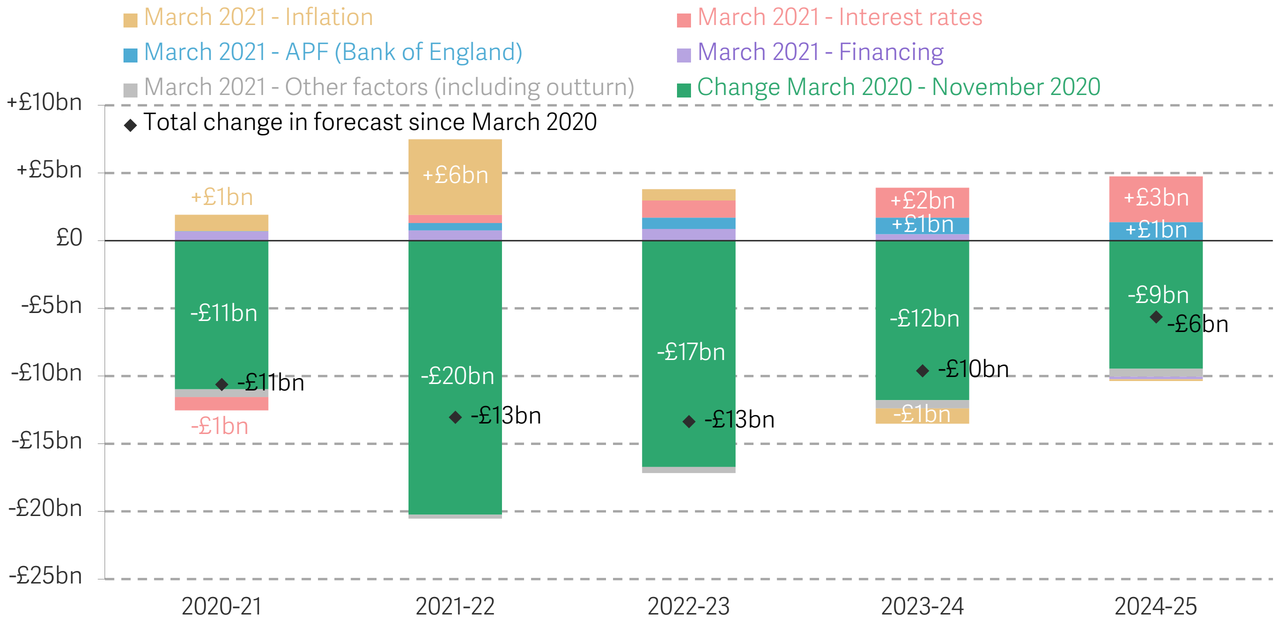
NOTES: Historical outturn spliced using time series from Fiscal Risks Report, 2019.
SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, March 2020, November 2020 and March 2021.

However, although last November's forecasts revised debt interest costs downwards by £20 billion next year, and £9 billion by the end of the forecast, some of this reduction has been removed in the new forecasts at this Budget, as shown in Figure 15. Around 36 per cent of this fall in 2021-22, and 40 per cent of the fall in 2024-25 have now been 'lost' – partially due to positive reasons. In 2021-22, debt interest has been revised upwards by over £6 billion largely due to the increased inflation associated with a swifter-than-expected recovery.

But the flipside of this 'good news' concerning the speed of the recovery is a rebound in market expectations, and so interest rates. This results in increases in debt interest towards the end of the forecast, with increases of around £4 billion projected by 2024-25 due to higher interest rate and Bank Rate forecasts. This effect could have been even more pronounced in the forecast, given that gilt yields have increased significantly since the data used for the OBR forecasts was finalised on 5th February. As noted in the OBR Economic and Fiscal Outlook, if a cut-off date of 26th February had been used instead, further rises in gilt yields would have added over £6 billion more to projected debt interest costs in 2025-26.

FIGURE 15: **The increase in the debt interest forecast since November is mainly driven by higher interest rates**

Change in central government debt interest, net of the Asset Purchase Facility, since March 2020: UK, 2020-21 to 2024-25



SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, November 2020 and March 2021.

This reminds us that policy makers should pay attention to the sensitivity of debt interest payments, while avoiding considering the impacts of changes to interest rate and inflation on them in isolation from the wider economic trends (such as stronger growth) that drive them. Box 1 discusses how a clear credible fiscal framework can help to provide certainty about the future sustainability of the public finances.

BOX 1: The Chancellor is reluctant to set new fiscal rules but is operating as if he has

It was striking that, in the Budget, the Chancellor once again decided not to announce a new set of fiscal rules. His argument was that it is too early, given the uncertainty over the economy's prospects, to constrain fiscal policy by announcing a new set of rules.

But doing so would provide certainty about the Chancellor's dual strategy of delivering a recovery and then ensuring that the longer-term fiscal position remains sustainable. It is also clear that, in practice, he is operating a fairly traditional set of guides to fiscal policy, with major policy decisions being taken to achieve the objectives of a falling level of net debt and a current budget balance by the middle of this decade.

Our view is that the best framework for guiding fiscal objectives is one that has net worth, rather than net debt, targeting at its heart.[7] By focusing on the assets the government has, not just the debt it owes, this would enable a focus on long-term fiscal sustainability while facilitating the key economic reforms the Government intends to pursue, such as achieving its net-zero and levelling-up agenda. By contrast, a focus on net debt is likely to lead to significant pressure to cut investment spending in the years ahead given pressures for additional current spending and the challenges of raising taxes.

The big news in this Budget has been on the policy side

While the economic forecasts have changed, particularly in the short term, the major news in this Budget was the big policy choices, as the Chancellor faced three linked but distinct challenges. First, how to provide the necessary support to families and firms in the remaining months of social distancing restrictions so that they can emerge from the crisis in strong position. (This element can be thought of as the economic policy counterpart to the 'roadmap' for opening the economy). Second, looking to the medium term, there is the question of how much additional stimulus would be needed to drive a rapid recovery. And third, once the recovery is secured, the Chancellor had to decide how to repair the damage to the public finances. Consistently across them, he provided bigger answers than many were expecting, with British firms particularly affected by his choices. We discuss each of these challenges below.

7 R Hughes, J Leslie, C Pacitti & J Smith, Totally (net) worth it: The next generation of UK fiscal rules, Resolution Foundation, October 2019.

Challenge 1: phasing out of crisis support for families and firms

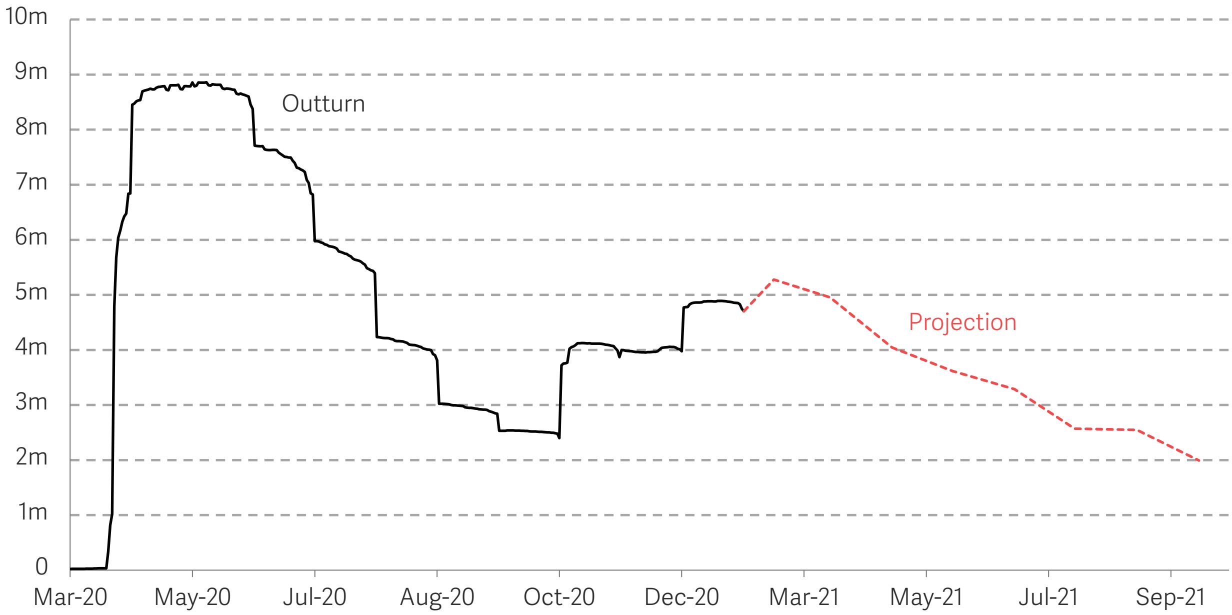
The Chancellor has extended key employment support measures

In recognition of the fact that restrictions to reduce the spread of Covid-19 are set to continue until the summer, the Chancellor extended both the JRS and the SEISS until the end of September. An extension is welcome: these schemes were previously set to finish at the end of April, at which point many sectors will still be subject to restrictions, and the OBR expects the economy to be operating 8 per cent below pre-crisis levels (see Figure 1).

With the extension until the end of September, the OBR expects the number of jobs supported through the JRS to decline gradually as the economy opens up, with 2 million workers remaining on furlough as the scheme comes to an end (see Figure 16). By the time the JRS ends entirely at the end of September, it will have been operational for 18 months rather than the three originally intended, having protected more than 11 million jobs.

FIGURE 16: **JRS take-up is expected to fall to 2 million before ending in September**

Number of employees furloughed through the Coronavirus Job Retention Scheme, outturn and OBR projection: UK, 2020-2021



SOURCE: HM Revenue & Customs, Coronavirus Job Retention Scheme (CJRS) Statistics, February 2021; OBR, Economic and Fiscal Outlook, March 2021.

The withdrawal of the JRS is now much more in line with the Government's roadmap for easing restrictions which culminates in all substantive restrictions being lifted by the end of June. The JRS will be then phased out over the following three months via steadily-rising employer contributions.

For most of the economy, this timetable provides a long period of adjustment, but timescales will be tight for some of the hardest-hit sectors even if there is no slippage in plans for reopening: full furlough ends just six weeks after hospitality can reopen indoors, for example, and only ten days after nightclubs and large event venues can fully reopen. Given big differences in how quickly sectors can legally reopen, there is a strong case for support, too, to be targeted by sector.[8] As currently announced, the JRS extension does not allow flexibility to extend support if there is any delay in easing restrictions. It is understandable that the Chancellor wants to give businesses certainty over specific dates, but he should explicitly tie the withdrawal of the JRS to the lifting of restrictions to provide assurance that support will not be removed before businesses can fully reopen.

This extension of the JRS will disproportionately benefit lower- and middle-income households, reflecting the large impact of the crisis on lower earners. Using the data for our Covid-19 surveys (conducted by YouGov and funded by The Health Foundation), we have estimated the distributional incidence of the extension to the JRS.[9] The results, using household incomes in the survey period (January 2021) rather than pre-crisis incomes, are shown in Figure 17. As this makes clear, we estimate that the extension of the scheme continues to support individuals with incomes in the second quintile the most.

In parallel, the Chancellor also announced two new rounds of SEISS grants. In another welcome move, he has extended support to 600,000 people based on 2019-20 tax returns, including those who were newly self-employed in 2019-20 as well as those whose 2019-20 tax returns mean they met the other eligibility criteria.[10] The fifth round of SEISS grants will also be better targeted at those who need it: people whose income has fallen by less than 30 per cent will receive a grant covering 30 per cent of their previous profits, while those with higher income falls will get 80 per cent. Although this still leaves a blunt cut-off (someone with a 30 per cent loss can get an 80 per cent grant, while someone with a 29 per cent loss can only get a 30 per cent grant), it does at least go some way to

8 We have previously recommended that the full JRS should be extended for at least two months after the current national lockdown ends, but crucially that it should be maintained for longer in the hardest-hit sectors (for at least two months after that sector can fully reopen). If the Government extended the full JRS for two months after each sector was allowed to reopen, and then phased out over a further two months, the JRS would end in the majority of sectors by mid-September, and in nightclubs and large event venues by mid-October, at the very earliest. See: N Cominetti et al., Long Covid in the labour market: The impact on the labour market of Covid-19 a year into the crisis, and how to secure a strong recovery, Resolution Foundation, February 2021.

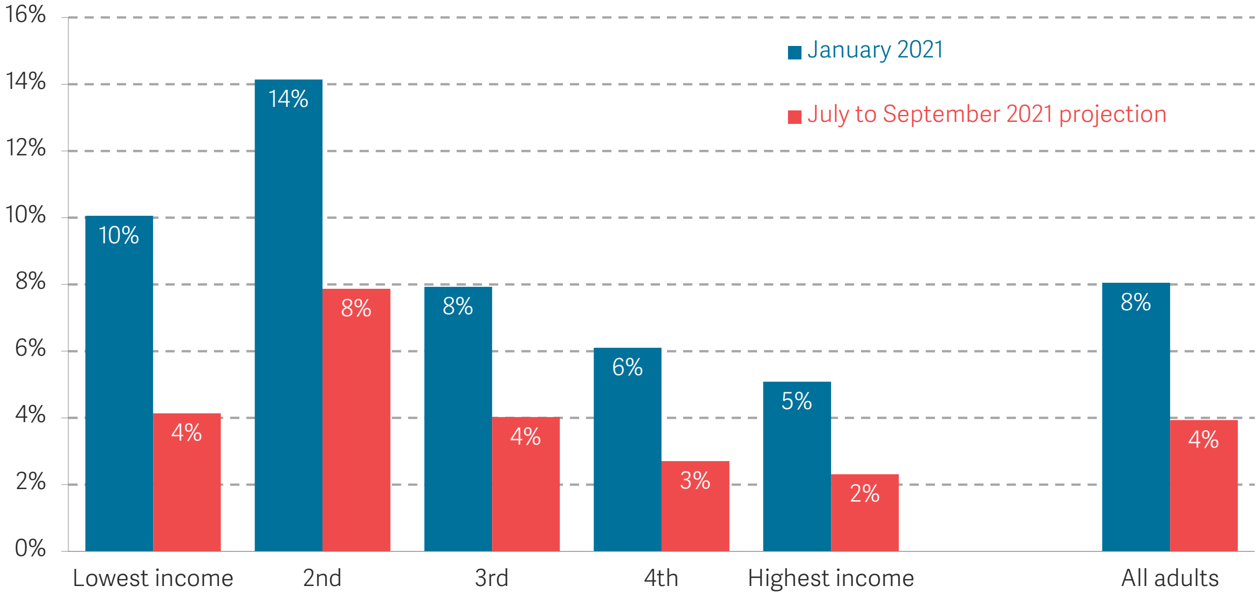
9 These online surveys were commissioned in September 2020 (conducted between 17 and 22 September 2020) and in January 2021 (conducted between 22 and 26 January 2021). The January survey was of 6,389 working-age adults, and figures have been weighted and are representative of all UK adults (aged 18 to 65). All figures presented from the survey have been analysed independently by the Resolution Foundation and the views expressed here are not necessarily those of the Health Foundation or YouGov.

10 For example, someone would now be newly eligible if they earned less than half their income from self-employment in 2018-19 because they also had an employee job, but in 2019-20 got all their income from self-employment.

correcting for the fact that previous rounds of the scheme have given large grants to those suffering only very minor income falls or no falls at all.[11]

FIGURE 17: **The furlough extension benefits in-work lower-income households the most**

Estimated proportion of adults aged 16 to 64 in receipt of furlough payment in January 2021, and expected to receive furlough support in July to September 2021, by current family income quintile: UK, 2021



NOTES: Sample base = 3,384: all adults aged 18-65 with valid income data (apart from the 'all' category where the base is 6,389). This explains why the average quintile result does not equal the all adult result. Family income distribution based on equivalised, disposable benefit unit incomes among 18-65-year-old adults, excluding families containing retired adults or nonworking adult students (see Annex 1 of K Hansdcomb and L Judge, Caught in a (Covid) trap: Incomes, savings and spending through the coronavirus crisis, Resolution Foundation, November 2020, for more details). Forecast figures calculated in line with OBR forecast for share of employees that will be furloughed, and adjusted by sectors expected to still be affected. These figures have been analysed independently by the Resolution Foundation.
SOURCE: RF analysis of OBR, March 2021 EFO; YouGov, UK Adults Age 18 to 65 and The Coronavirus (Covid-19) – January wave (conducted 22 to 26 January).

The Chancellor has, however, missed an opportunity to better target support at other groups who have been omitted. We have estimated that, in January 2021, 1.5 million self-employed workers said that they had been ineligible for support despite facing lower profits as a result of the pandemic[12] – meaning that even if all those newly-eligible for support needed it, the eligibility expansion would still only capture two-fifths of those who have been left without support. Those previously earning above £50,000, those whose self-employment income was lower than their employee earnings, and those who

11 For example, see: M Brewer et al., Jobs, jobs, jobs: Evaluating the effects of the current economic crisis on the UK labour market, Resolution Foundation, October 2020.
12 N Cominetti et al., Long Covid in the labour market: The impact on the labour market of Covid-19 a year into the crisis, and how to secure a strong recovery, Resolution Foundation, February 2021.

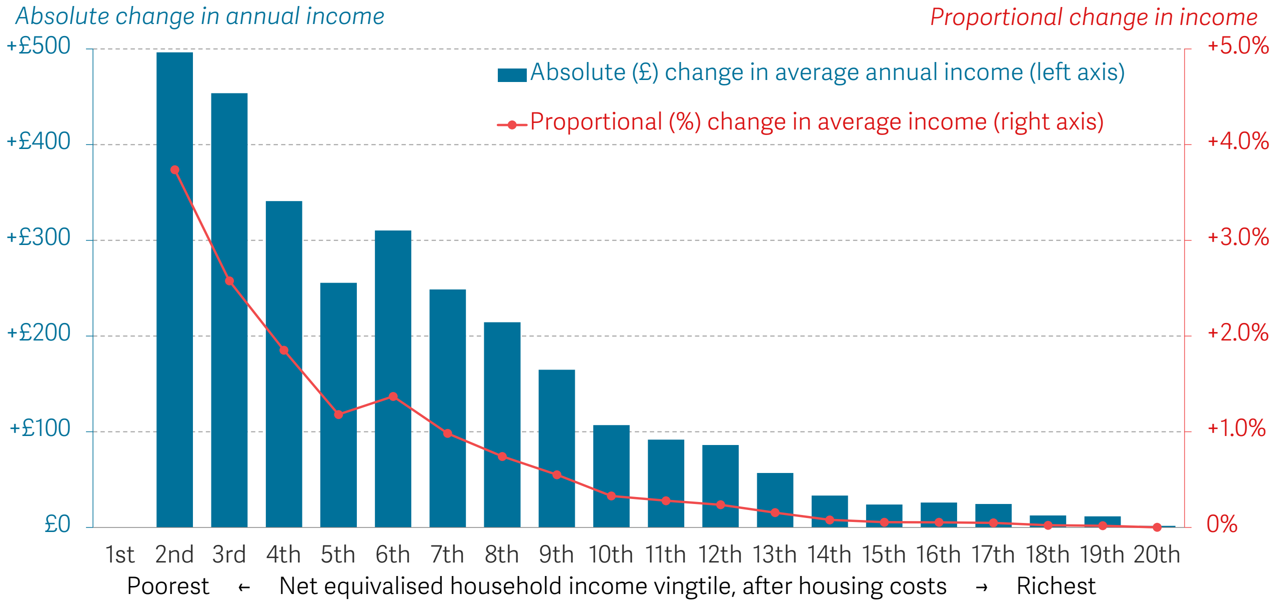
paid themselves in dividends remain ineligible for the SEISS. And support for the newly-self-employed group has not been backdated, even though the only reason they did not receive support was that the Treasury lacked the information that it now has.

The six-month boost to Universal Credit and Working Tax Credit provides some support for lower-income households

The Chancellor also announced that he is extending the £20 a week uplift to Universal Credit (UC) for another six months, with an equivalent one-off payment of £500 for those receiving Working Tax Credit (WTC), at a total cost of £3 billion. Compared to the policy of doing nothing, this extension provides welcome protection for living standards: the extension of the uplift will raise the incomes of the poorest households by more than 3 per cent over the course of 2021-22, as Figure 18 shows.

FIGURE 18: **The extension to the UC boost provides a six-month respite to out-of-work and low-income working families**

Impact on average annual household income of extending £20 per week boost to Universal Credit and Working Tax Credit for six months, by household income vingtile: 2021-22, UK



NOTES: We exclude the bottom 5 per cent, due to concerns about the reliability of data for this group.
SOURCE: RF analysis of DWP, Family Resources Survey, using the IPPR tax-benefit model.

But the Chancellor has only delayed, rather than eliminated, the cut to UC. Low-income families still face a living standards hit in the coming year: if the Chancellor goes ahead with removing the uplift at the beginning of October, the poorest households will face a 7 per cent fall in income in the second half of 2021-22.[13] Furthermore, the removal of the

13 See: M Brewer et al., The Living Standards Outlook 2021, Resolution Foundation, January 2021 and M Brewer and K Handscomb, Safe harbour? Six key welfare policy decisions to navigate this winter, Resolution Foundation, October 2020.

£20 a week increase is still set to coincide with the peak of unemployment in Q4 2021 and would see the basic level of benefits reduced to levels last seen in the early 1990s. Not only would a cut at this point be disastrous for family incomes, but it is also bad macroeconomics: taking £3 billion out of the economy in 2021-22, especially from the lowest-income households (who are most likely to spend the extra cash), will only harm the recovery.[14]

The Budget also did not provide any equivalent uplift for legacy or contributory benefits such as Income Support, Job Seekers Allowance, and Employment Support Allowance (ESA). By the time the UC uplift comes to an end at the end of September, the roughly 2.5 million people claiming these benefits will have faced an 18-month gap of reduced support compared to their counterparts receiving UC.[15] For example, a couple claiming income-related ESA with the support component and enhanced disability premium (and who are also claiming a Personal Independence Payment), living in social housing would have been 13 per cent better-off had ESA also had the £20 a week increases.

Support for firms has been extended

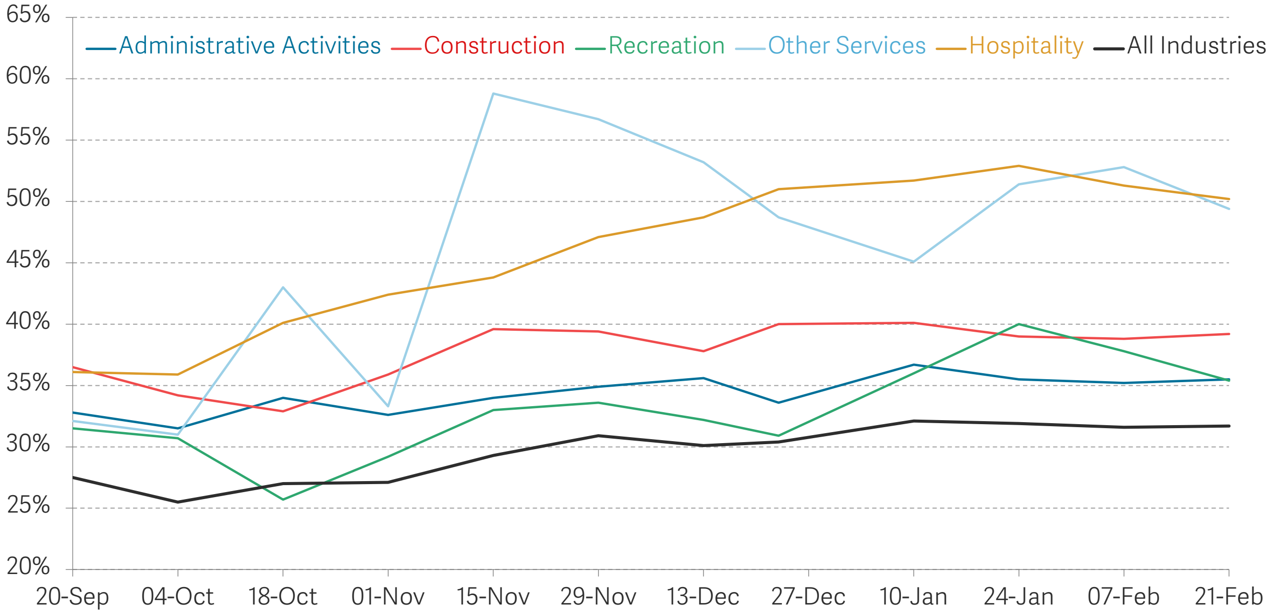
Firms overall have been surprisingly resilient during this crisis, but pockets of distress have been growing in the corporate sector, particularly since the ramping up in social-distancing restrictions from the Autumn last year. For example, more than half of hospitality businesses said they had less than three months of cash reserves at the end of February 2021, as Figure 19 shows.[16] This highlights the need for continued crisis support to be targeted at hospitality and other face-to-face services, and at smaller firms.

The additional business rates relief and targeted grants announced in the Budget go a long way to meet this need. The Chancellor extended the business rates holiday for retail, hospitality and leisure businesses until the end of June, with further discounts through to the end of 2021-22, and there will another round of grants of up to £6,000 to non-essential retail businesses and £18,000 to hospitality and leisure businesses during the first months of 2021-22. This support is well targeted at sectors of the economy that will remain largely closed into the spring, and providing support through grants rather than loans will help reduce the debt burden on firms during the recovery.

14 T Bell, A Corlett & K Handscomb, Death by £1000 cuts? The history, economics and politics of cutting benefits for millions of households next April, Resolution Foundation, October 2020.
15 Source: DWP benefit statistics: February 2021.
16 See: N Cominetti, J Leslie & J Smith, On firm ground? The impact of Covid-19 on firms and what policy makers should do in response, Resolution Foundation, February 2021.

FIGURE 19: **More than half of hospitality businesses were in need of cash in late February**

Proportion of businesses reporting less than 3 months of cash reserves remaining, for all businesses and selected industries: UK, September 2020 to February 2021



NOTES: 'Other services' includes membership organisations, repair of household/personal goods and personal care services. Results are shown for the industries with the five highest share of low-cash reserves firms. A version of this chart first appeared in: N Cominetti, J Leslie & J Smith, On firm ground? The impact of Covid-19 on firms and what policy makers should do in response, Resolution Foundation, February 2021.
SOURCE: RF analysis of ONS, Business Impacts of Coronavirus (COVID-19) Survey.

The Chancellor also launched a further round of business loans: the Recovery Loan Scheme, which guarantees 80 per cent of loans between £25,000 and £10 million. These loans are unlikely to see anything like the take-up of previous rounds of government-supported loans, but that is not a huge concern given the limitations on the role that further loans can fill at this stage: support is better targeted (via grants) at the sectors where cash flow is a problem.[17] The new round of loans does move away from guaranteeing 100 per cent of loans, which is to be welcomed, as it reduces the risk that banks lend money to firms likely to become insolvent.[18]

Support for the housing market is inevitable but at least partly misplaced

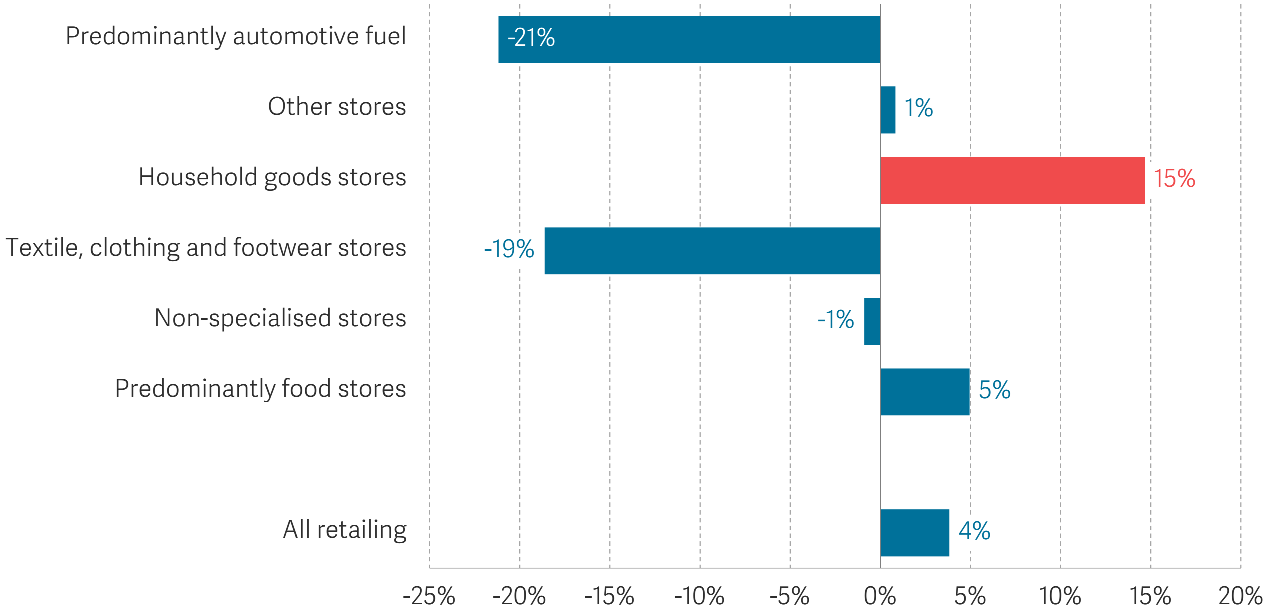
As well as providing more labour market support, the Chancellor made another concession to the longevity of the crisis by extending the stamp duty holiday first introduced in July 2020.[19] This makes sense from an equity point of view: it will help those who intended to complete their house purchase during the stamp duty holiday

17 See: N Cominetti, J Leslie & J Smith, On firm ground? The impact of Covid-19 on firms and what policy makers should do in response, Resolution Foundation, February 2021.
18 The OBR has estimated that take-up of the Recovery Loan Scheme will reach £12 billion in 2021-22, with estimated write-offs of just under £1 billion (less than 10 per cent).
19 It continues in full until the end of June 2021, and in a diluted form until the end of September 2021.

period, but who have got snarled up as a result of renewed social restrictions. Beyond this, however, there is little policy rationale for the extension. One reason for undertaking such a policy is that it will act to boost other types of spending – most obviously durable household goods, which are often bought around the time of new house purchases. But, as Figure 20 shows, the Covid-19 period has been characterised by high levels of spending on durables such as furniture and other home improvements – sales in household goods increased 15 per cent over the course of 2020 – meaning the stimulus effect of this measure is directed towards a part of the economy that is already performing relatively well.

FIGURE 20: **Household spending on durables has increased significantly over the pandemic period**

Change in volume of retail sales by type of retailer: UK, Q4 2019 to Q4 2020



SOURCE: RF analysis of ONS, Retail sales.

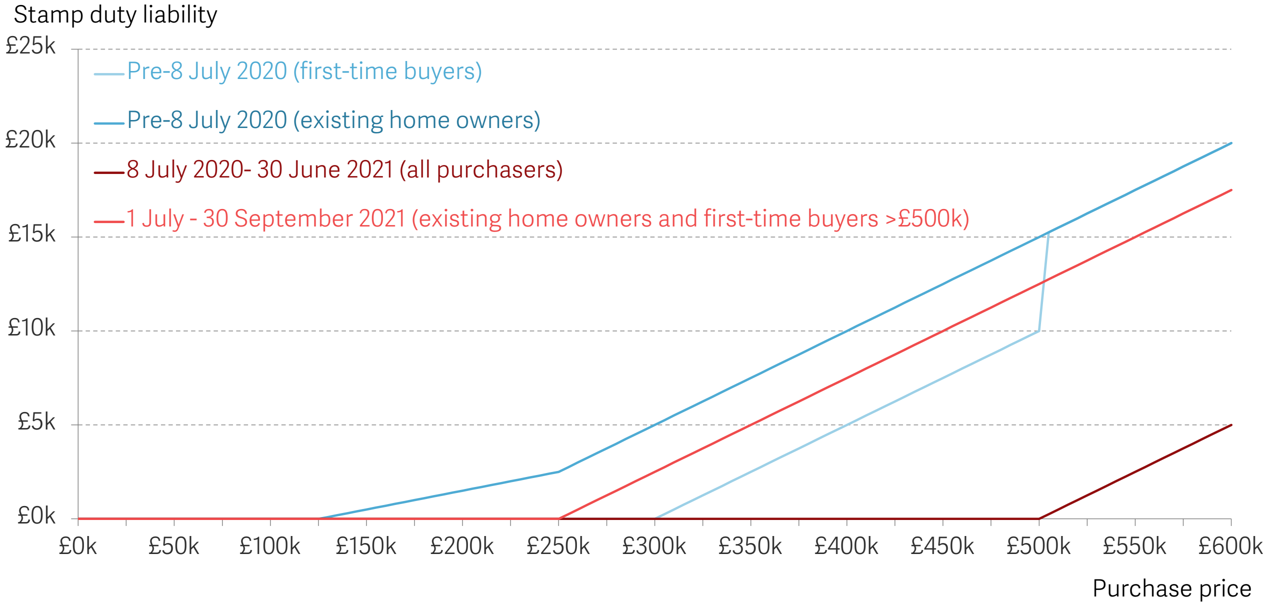
Moreover, the stamp duty holiday extension is bad news for aspiring home owners for two key reasons. First, it is clear that lower stamp duty liabilities have contributed to house prices rises over the last eight months: house prices in England grew 7 per cent between July and December 2020, highly unusual behaviour during a recession.[20] Second, the stamp duty holiday has the perverse effect of (temporarily) removing an advantage that first-time buyers had in the market compared to existing home owners. Figure 21 illustrates the point. Prior to July last year, first time buyers purchasing a home costing £500,000 or less paid no stamp duty on the first £300,000 'slice', compared to existing owners who paid no tax on the value of their new home only up to £125,000.

20 Source: RF analysis of ONS, UK House Price Index: December 2020, ONS, February 2021. For an overview of house prices in previous recessions see: L Judge and C Pacitti, Housing Outlook Q3 2020, Resolution Foundation, August 2020.

During the stamp duty holiday period, however, the tax treatment of first-time buyers and movers has been equalised. In practical terms this means that both a first-time buyer and an existing owner purchasing a home at the average UK house price of £250,000 in December 2020 paid no stamp duty as a consequence of the holiday, compared to zero and £2,500 respectively they would have been liable for in its absence.

FIGURE 21: **First time buyers have lost their comparative advantage in the housing market during the stamp duty holiday**

Stamp duty liability on main residence, by purchase price and type of buyer: England, November 2017 to September 2021

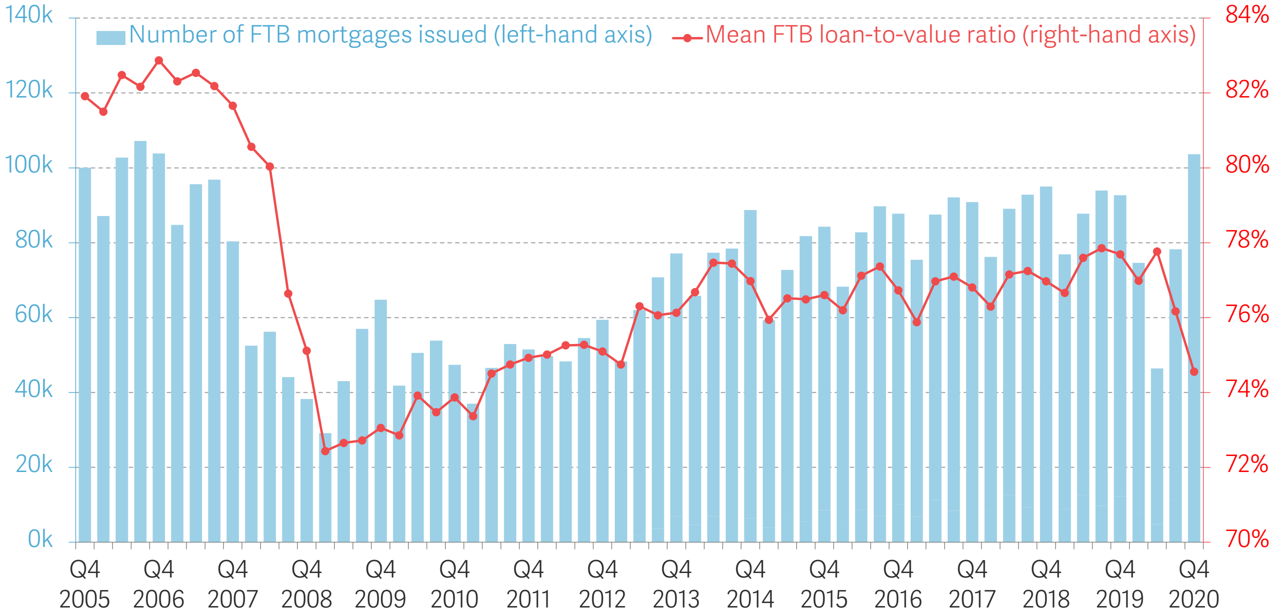


NOTES: Chart shows stamp duty liability for those purchasing main residence only as different rules apply for second homes and buy-to-let. First-time buyer relief introduced 22 November 2017.
SOURCE: RF analysis of SDLT rates, GOV.UK.

Possibly more helpful to first-time buyers is the reintroduction of a Help to Buy Mortgage Guarantee Scheme. This allows lenders to offer more generous loan-to-value mortgages to those who want to buy a new home but who lack a significant deposit. The demand for such a scheme is clear: mortgage lending has tightened in response to Covid-19 crisis, leaving the mean loan-to-value ratio for first-time buyers at a level last observed in 2011 (see Figure 22). That said, first-time buyer activity has bounced back considerably in recent months, and there is also a risk that future falls in house prices (which the OBR are projecting for the second half of 2021 and 2022) mean that those on this scheme will fall into negative equity.

FIGURE 22: **First-time buyer activity bounced back in the second half of 2020 despite credit conditions tightening**

Number of first-time buyer mortgages issued and mean first-time buyer loan-to-value ratio: Q2 2005 to Q4 2020, UK



SOURCE: RF analysis of UK Finance Table RL1: First-time buyers, new mortgages and affordability, UK countries and regions.

Challenge 2: how to drive a rapid recovery

The second challenge the Chancellor faced at Spring Budget was how to make sure the recovery was rapid and broad-based. This is important not only because it will limit hardship in the coming months, but also because a rapid recovery will reduce the economic damage from the pandemic – for example, by reducing longer-term unemployment. This is made all the more important because the low level of short- and longer-term interest rates mean the Bank of England in unable to do much more to boost the economy, so fiscal policy is playing the lead role in supporting the economy.

Coming into the Budget, expectations for additional stimulus were low given the apparent priority of fixing the damage to the public finances. But, in the event, significant support was announced.

The measures fall in three main categories: stimulus for firms; support for household spending; and labour market policies designed to bring down unemployment. We discuss briefly the microeconomic impacts of measures in each category, before turning to what they collectively might mean for the recovery's prospects. These measures come on top of pre-existing plans for significant increase in capital spending by government, first announced in broad terms in Budget 2020.

Stimulus measures to boost firms' demand

Alongside the continued measures to support firms through the next few months, by far the biggest new stimulus measure was focused on boosting business investment. This is a particular area of concern given the weakness of business investment in recent years.[21]

To address this, the Government is introducing a two-year 'super-deduction tax incentive policy' from April 2021. At a cost of £24 billion, this allows companies to claim 130 per cent relief for capital expenditure on plant and machinery.[22] This significant subsidy of business investment allows companies to reduce their corporation tax base by 30 per cent more than the actual cost of the investment.

To see how this works, suppose a firm wants to invest £100 in a machine that will increase pre-tax profits by £5 per year. With a tax on profits of 20 per cent (approximately equal to the current statutory rate of 19 per cent), this investment would provide £4 per year after tax in additional profits, or an annual return of 4 per cent of the initial investment. With the 130 per cent investment allowance, taxable profits fall by £130 in the year the asset is expensed, so taxes fall by 20 per cent of £130, or £26. The post-tax cost of the machine is now £74, so this policy cuts the cost of investment by roughly one-quarter. The annual return on the machine after the incentive will be £4 divided by £74 – equivalent to 5.4 per cent of the initial net cost of the investment – a greater return than the pre-tax return.

However, when the existing system of capital allowances is considered, the additional effect of the investment subsidy is more limited. Firms can already deduct 100 per cent of investment outlays from their taxable profits up front, subject to a limit, and can claim any excess over time as capital allowances. Because these capital allowances defray taxes at a later date, their present value is worth less, perhaps around three-quarters of the initial outlay.[23] Net of these allowances, the super-deduction reduces the cost of investment by something more like 12 per cent, rather than one quarter.

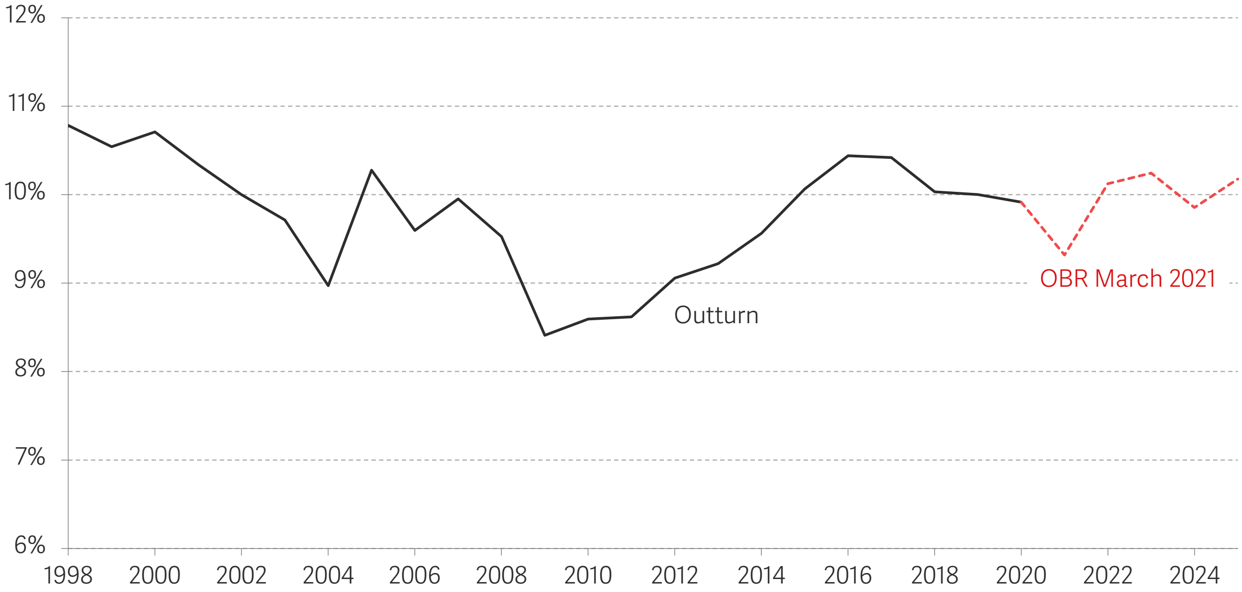
This scheme will boost investment in the next two years, although the size of its impact is very uncertain. The OBR suggests that this policy will boost capital investment by around 10 per cent over two years – or around £40bn. However, only around one-fifth of business investment by asset (qualifying types of plant and machinery) appears to be eligible for this relief, so this component will need to be boosted by around 50 per cent to increase the total this much. The impact of this temporary policy will also largely be felt by encouraging firms to bring forward investments from future years rather than increasing

21 See: N Cominetti, J Leslie & J Smith, On firm ground? The impact of Covid-19 on firms and what policy makers should do in response, Resolution Foundation, February 2021.
22 In the short-run, the Government will also allow for a greater carry-back of losses in the CT system, with companies and the self-employed allowed to carry back up to £2 million of losses that fell in 2020-21 or 2021-22.
23 See E Asen, Capital Cost Recovery across the OECD, Tax Foundation, April 2020.

the total volume of investment – indeed the OBR assume it has no lasting effect on the size of the UK's capital stock. So this policy should be seen as a valuable support to overall levels of activity at a time when risks to demand are on the downside, but it will not provide a durable solution to the UK's low levels of investment.

FIGURE 23: **Business investment will remain below its recent peak as a share of GDP**

Ratio of real business gross fixed capital formation to real GDP, chained volume measure: UK, 1998 to 2025



SOURCE: RF analysis of ONS, National Accounts; OBR, Economic and Fiscal Outlook, March 2021.

Stepping back, the investment forecast for the near-term is for strong growth, but not to especially high levels (Figure 23). In other words, even if these incentives work as intended, business investment in the UK will remain a relatively small fraction of the economy, compared to both the past, and to other industrialised countries.

Stimulus measures to boost household spending

Fiscal stimulus packages often include measures to boost business investment, but their mainstay is normally measures to boost household spending, not least because this constitutes up around two-thirds of final demand in the UK.[24] Here, Budget 2021 included a number of small measures that should provide an additional boost to consumption. As well as some small tax giveaways discussed below, the Chancellor confirmed that the 5 per cent rate of VAT for supplies of accommodation, food and beverage services excluding alcohol, and specified attractions will continue in full until 30 September, and

24 See: J Leslie et al., How to throw good money after good: Budget 2021 and the challenge of delivering a rapid recovery from Covid-19, Resolution Foundation, February 2021.

then a rate of 12.5 per cent will apply until March 2022, before returning to the standard rate of 20 per cent. Together, these reduced rates are estimated to cost the Treasury £4.7 billion. Businesses benefiting from this have the choice over how much of the tax cut to pass on to customers. To the extent that firms pass this on, the cut should encourage greater activity in these areas.

But it was striking that there was much less new policy support for household spending than for firms. The key judgement that the Chancellor has made is that the necessary level of support for household finances has already been provided by income support during economic restrictions (such as the JRS) and the 'enforced' savings built up by some households during the pandemic. It is assumed that reduced social-distancing restrictions will provide a sufficiently strong boost to consumption without the need for further policy support. We agree that these factors should support household spending, but note that the outlook is uncertain, that household incomes will face a renewed squeeze in the Autumn as unemployment rises, and that, even if consumption bounces back in the hospitality and leisure sectors that are most affected by lockdowns, it does not follow that overall economic demand will be robust. The Chancellor's approach on this issue is broadly consistent with the OBR's forecasts, but not those of other organisations like the IMF who anticipate a much weaker recovery in demand. Our view is that the balance of risks would have suggested more support for household incomes, such as maintaining the £20 Universal Credit uplift through the Autumn and into 2022.

Stimulus measures to support the labour market

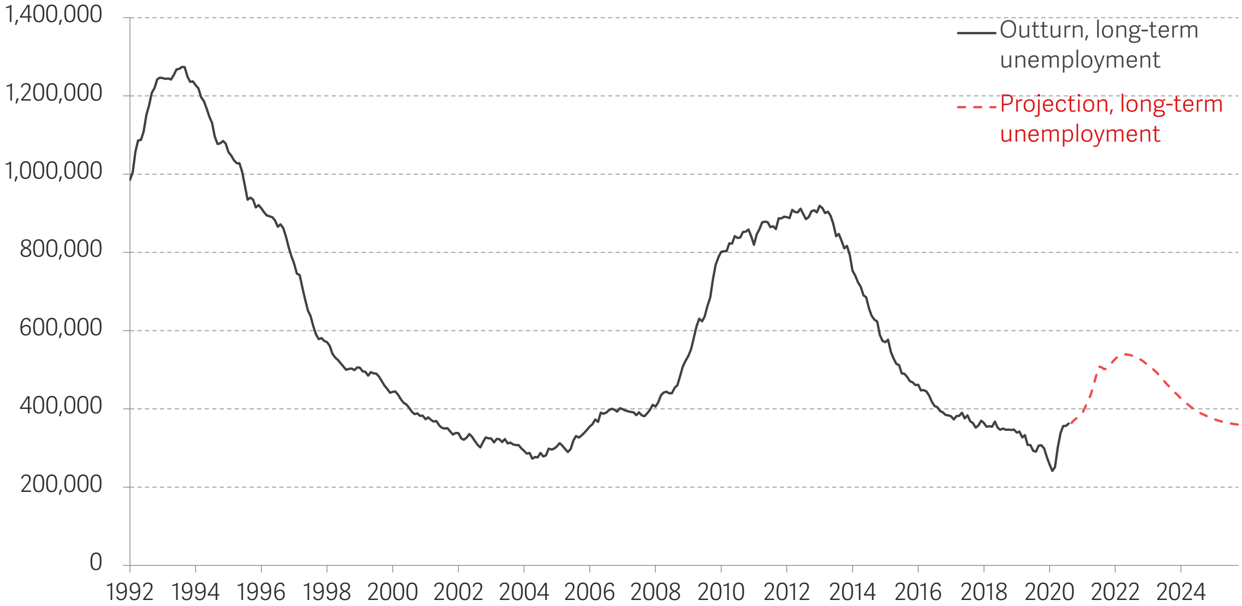
With unemployment set to rise, the final key area we might have expected more stimulus was the labour market. Here, as discussed in our previous work, the objective for policy makers is to ensure unemployment falls as quickly as possible.[25]

But there was little by way of new labour market policies aimed at getting people back into jobs. The Chancellor highlighted Restart, an employment support programme for the long-term unemployed, but did not commit any additional resource to it. The Restart scheme, announced at November's Spending Review and due to go live in June, is set to be at a sufficient scale to absorb the projected rise in long-term unemployed people (see Figure 24). However, if, as we have recommended, time on full furlough counts towards Restart eligibility, the Government will need to ensure that providers have capacity to meet extra demand. This will be particularly important if large numbers of long-term furloughed workers become redundant after the JRS draws to a close in September, when many providers will still be in building up their support capacity.

25 See: N Cominetti et al., Long Covid in the labour market: The impact on the labour market of Covid-19 a year into the crisis, and how to secure a strong recovery, Resolution Foundation, February 2021.

FIGURE 24: **Long-term unemployment is set to peak in 2022**

Number of 16+-year-olds unemployed for 12+ months, outturn and projection: UK, 1992-2026



NOTES: This projection accounts for past lags in the transmission from headline to long-term unemployment using historical levels of headline 16+ unemployment and 16+ long-term unemployment, and the OBR's March 2021 16+ unemployment forecast.
SOURCE: RF analysis of ONS, Labour Market Statistics; OBR, Economic and Fiscal Outlook, March 2021.

The most significant policy change when it comes to labour market stimulus was on apprenticeships, with a change to the hiring incentives launched last summer. The incentive employers receive for hiring a new apprentice will be extended to September 2021, and raised from £2,000 to £3,000 for apprentices of all ages.[26] But there are still reasons to worry this will not be enough to incentivise firms to take on apprentices at any age, and especially younger apprentices who often need greater levels of support in the workplace.[27] First, previous schemes that offered employers cash to hire young people proved disappointing.[28] So, too, has the initial apprenticeship incentive announced over summer: during the final three months of last year, it accounted for just 20 per cent of new apprenticeship starts. Second, having a flat bonus for all apprenticeships could skew the scheme towards older apprentices, and away from young people who have so far been disproportionately affected by falling employment.

26 This comes on top of a longstanding £1,000 bonus that firms receive when hiring a 16-18-year-old apprentices, or a 19-24-year-old apprentice on an Education, Health and Care Plan.

27 Nearly half (47 per cent) of all apprenticeship starts during the 2019/20 academic year were taken up by apprentices age 25 and older. Although the DfE do not publish administrative data on the number of apprentices who are new hires to the firm, previous DfE-commissioned apprentice surveys found that a large majority of apprentices age 25 and older were pre-existing staff. See: K Henehan, Trading up or trading off? Understanding recent changes to England's apprenticeships system, Resolution Foundation, August 2019.

28 For example, the Youth Contract which offered businesses up to £2,275 for taking on a long-term unemployed young person saw just 4,960 out of a planned 53,000 young people being recruited. See: P Wintour, Youth contract helped just 4,700 young people find work, The Guardian, July 2013.

In addition to the new incentive to take on apprentices, the Chancellor reaffirmed plans to double the number of work coaches in Job Centres, announced as part of last summer's Plan for Jobs, and reaffirmed the Lifetime Skills Guarantee, which was announced last autumn.[29]

These small measures aimed at bringing down unemployment are extremely welcome, but there is a risk that the Budget will do little to increase the pace of the recovery in the labour market. This is particularly a concern for younger workers given there were nearly 600,000 unemployed young people as of December, up 15 per cent from February 2020. There were no meaningful new policies to support job creation, or to help adults move back into work or change careers. This will become increasingly consequential towards the end of this year, when the JRS and UC uplift will have wound down, Kickstart will close, and, according to yesterday's OBR projections, unemployment will reach 2.2 million, 72 per cent higher than unemployment levels at the end of 2019.[30] This lack of new policy reflects an optimism that the rise in unemployment will be limited – as suggested by the OBR's forecast – with furloughed workers overwhelmingly returning to their jobs as the scheme is wound down. Clearly, there are risks to such an approach.

Fiscal policy remains active in the years ahead, but will become a significant drag on growth as the scale of support is reduced

Taking these measures designed to boost the recovery together, then, leads us to conclude that there is a very substantial stimulus in place when it comes to firms, but the risk is that too little has been done for households whose consumption makes up the bulk of economic activity. But there is also an important question about whether the stimulus announced at the Budget will be sufficient in aggregate to ensure a rapid recovery.

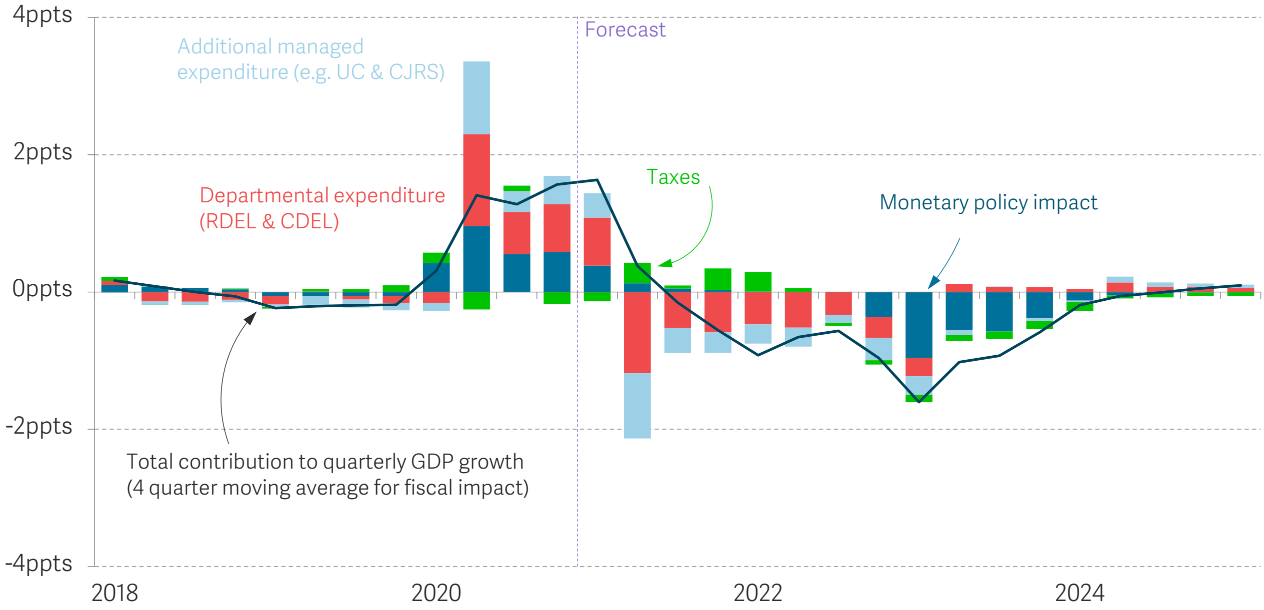
A good starting point is too look at the impact of fiscal policy on growth. Here our assessment is that the significant £67 billion of additional measures announced in the Budget over the next two fiscal years will boost output, and that the duration of support into 2022-23 is also very welcome. However, it may not be sufficient to stop fiscal policy becoming a drag on growth in the coming quarters. As Figure 25 shows, fiscal policy is estimated to have boosted quarterly GDP growth by at least 1 percentage point every quarter in 2020-21. This boost to GDP growth in 2020 will continue to support the level of GDP over the coming years, but fiscal policy is set to detract from growth in the coming quarters.

29 Under this scheme, adults without a Level 3 qualification can study free of charge for a selection of Level 3-equivalent courses, mostly relating to health, engineering, accountancy and construction. This will not be available to those who already have a Level 3 (A level-equivalent qualification or higher) who are unemployed or looking to retrain.

30 J Leslie et al., How to throw good money after good: Budget 2021 and the challenge of delivering a rapid recovery from Covid-19, Resolution Foundation, February 2021.

FIGURE 25: **Fiscal policy will become a drag on growth in the coming months**

Estimated impact of monetary policy and fiscal decisions (spending and taxes) on quarterly GDP growth, history and forecast: UK

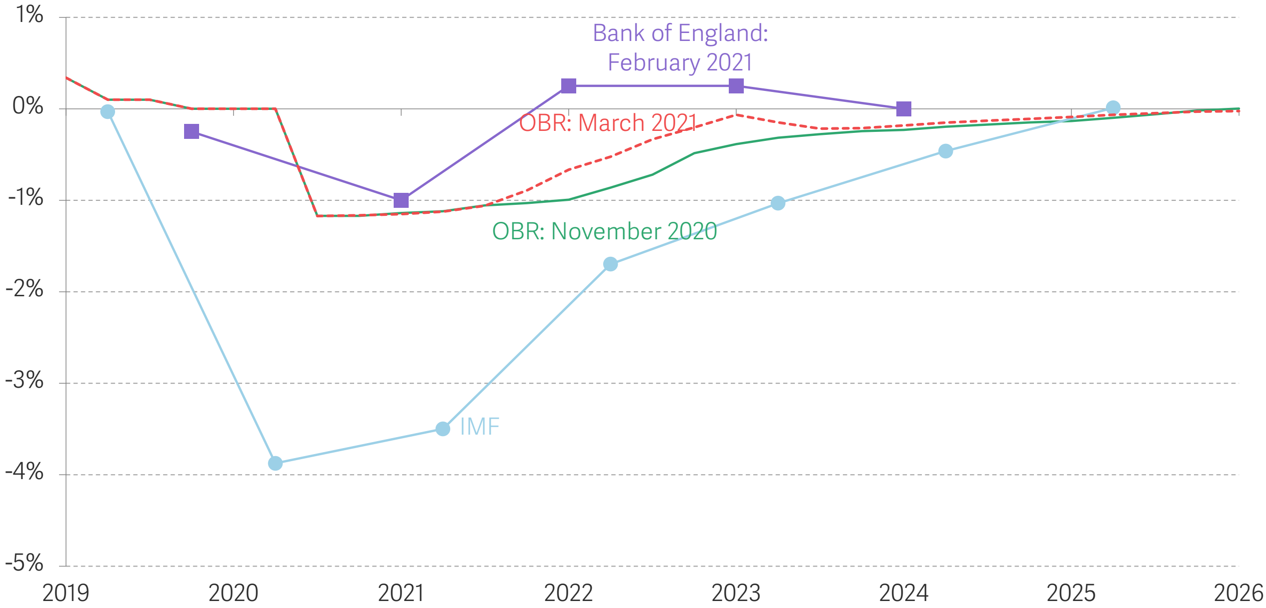


NOTES: Monetary policy impact is calculated using estimates from P Bunn, A Pugh & C Yeates, 'The distributional impact of monetary policy easing in the UK between 2008 and 2014', Bank of England Working Papers no.720, Bank of England, March 2018. This covers the Bank of England stimulus during the financial crisis. Subsequent changes in Bank rate and quantitative easing purchases are incorporated using equivalent scaling factors between policy changes and GDP. The fiscal policy impact is calculated based on a UK version of the Hutchins Center Fiscal Impact Measure, adjusted for the OBR's estimate of fiscal multipliers. The values for 2020 and 2021 are based on assuming Bank rate is held at 0.1 per cent and the OBR's March 2021 Economic and Fiscal Outlook.
SOURCE: RF analysis of OBR, various; ONS; Bank of England.

It would take a very large stimulus to stop fiscal policy dragging on growth (around £350 billion of additional fiscal measures). But such an estimate for the size of the required stimulus doesn't take into account other important influences on the economy – for example, the withdrawal of social-distancing measures. A more standard way to assess the extent to which a further policy boost is necessary is to look at the difference between actual GDP and its assumed sustainable level – often referred to as the output gap. The idea is that, to the extent that there is insufficient aggregate demand, unemployment will be higher, so there is a key role for policy makers in boosting demand to return to full employment. Based on the OBR's forecast for the output gap (shown in Figure 26), we estimate around £20 billion of additional stimulus would be warranted.

FIGURE 26: **The OBR's output gap forecast suggests limited spare capacity**

Range of forecasts for the output gap: UK, 2019-2026



SOURCE: RF analysis of Bank of England, Monetary Policy Report, February 2021; IMF, World Economic Outlook, October 2020; and OBR, Economic and Fiscal Outlook, various.

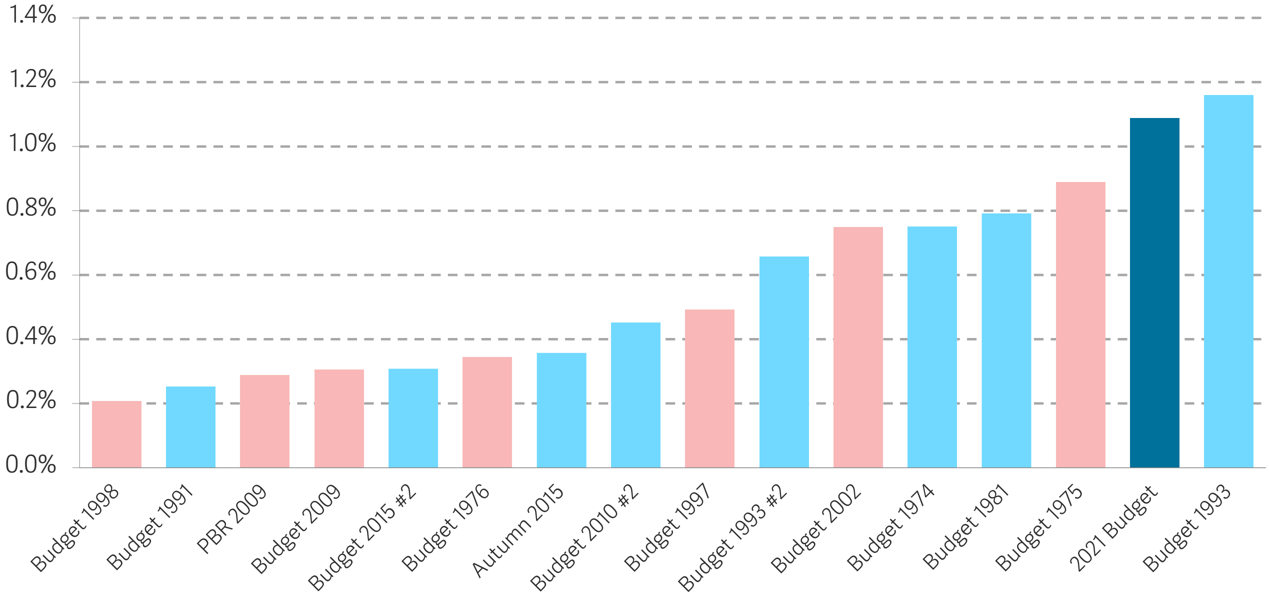
However, the output gap may be larger. Indeed, as shown in Figure 26, estimates other than the OBR of the output gap are considerably wider, and certainly the size of the output gap is extremely uncertain given the unusual nature of the pandemic. Our view is that the Chancellor has set out very significant fiscal support for the recovery, but that it would be wise to err further on the side of more stimulus and to prioritise supporting household incomes in so doing. This case is also strengthened by the fact that stimulus can have important impacts on the supply side of the economy too, meaning that the output gap may underestimate how much support fiscal policy should provide to maximise economic activity without the risk of rising inflation.

Challenge 3: repairing the damage to the public finances

As well as supporting the recovery, yesterday's Budget saw the Chancellor aim (in his words) to return the public finances to a sustainable path. The size of the tax rises pencilled in for the end of the forecast period was very large indeed, with Budget 2021 being the largest tax-raising fiscal event since Norman Lamont's 1993 Budget, increasing tax revenues by 1.1 per cent of GDP (see Figure 27).

FIGURE 27: **Announced tax rises are significant by historical standards**

Change in medium-term forecast tax revenue resulting from policy measures at selected fiscal events, as a share of contemporaneous GDP: UK, 1975 to 2021



NOTES: Medium-term is defined as the final year of the fiscal forecast for forecasts made by the OBR (i.e. since 2010) or the implied-fifth year forecast for fiscal events prior to the OBR's creation. GDP is defined as the outturn GDP in the corresponding calendar year of the forecast, or the most recent OBR forecast for the GDP level for those fiscal events where the outturn is not yet known. Red bars indicate Labour governments and blue bars represent Conservative governments and the Conservative-Lib Dem coalition Government in 2010.
SOURCE: RF analysis of OBR, Policy measures database and Economic and Fiscal Outlook, March 2021.

Corporation tax is doing most of the heavy lifting

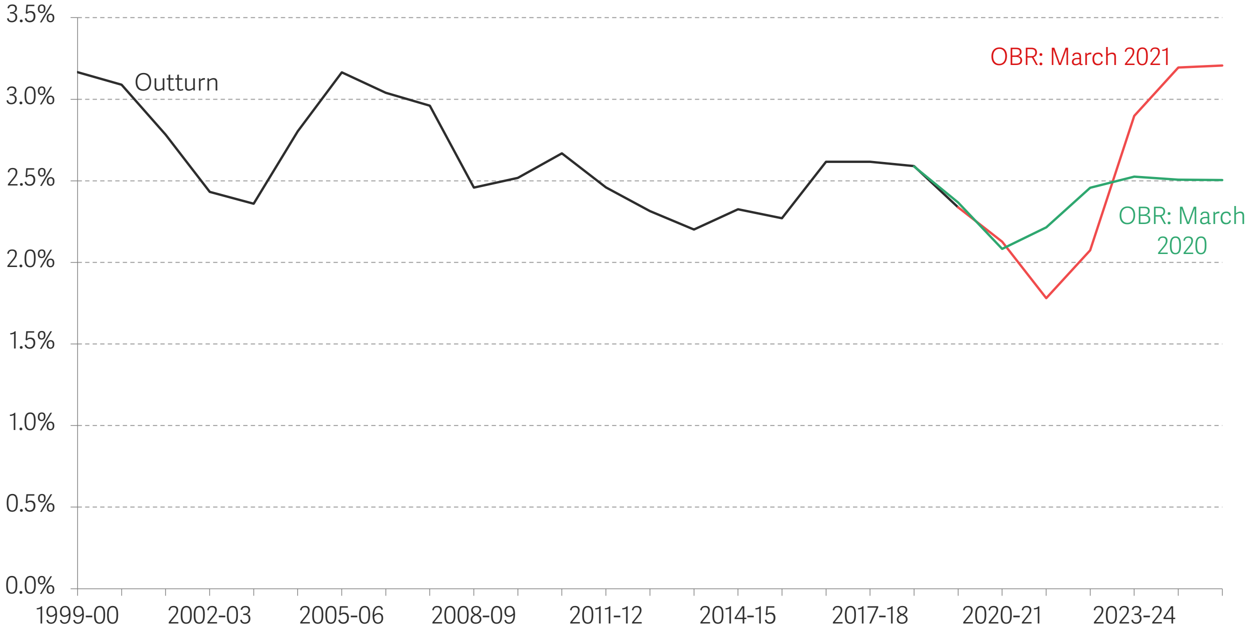
Changes to Corporation Tax had been widely-trailed, but the Chancellor announced a larger-than-expected rise in the main rate of Corporation Tax, which will go up from 19 per cent to 25 per cent in April 2023. Indeed, Budget 2021 contains the largest rise in Corporation Tax revenues announced at any fiscal event since at least 1973 with the rise in Corporation Tax revenues at the end of the forecast period represents 0.75 per cent of GDP (although Budget 2020 cancelled a long-planned cut to the rate of Corporation Tax due to take it from 19 to 17 per cent).[31]

Figure 28 shows how the change will affect Corporation Tax revenues as a share of GDP, showing that this share will reach its highest level since consistent records began in 1999-00.

31 See Figure 40 in G Bangham et al., Unhealthy finances: How to support the economy today and repair the public finances tomorrow, The Resolution Foundation, November 2020, drawing on OECD.Stat, Table II.1. Statutory corporate income tax rate.

FIGURE 28: **Corporation tax revenues will reach the highest share of GDP since at least 1999-00**

Corporation tax revenues as share of GDP, actual and projected: UK, 1999-00 to 2025-26



Note: Includes on-shore and off-shore CT revenues, and the Bank Surcharge.
SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, various.

The Chancellor was keen to stress that the full effect would be felt only by a small minority of companies, and this is because new main rate will apply only to companies with profits above £250,000: those with profits below £50,000 will continue to pay the current 19 per cent rate, with a sliding scale applying to those with profits between £50,000 and £250,000. The rise in the Corporation Tax rate will bring in £47.8 billion over the whole of the forecast period, although the enhanced capital allowances will return about half of that (£24.2 billion) to businesses. But this still represents a substantial net tax rise of £24 billion over the period, slanted towards the end of the period (indeed, almost £20 billion comes in 2025-26, with £17 billion coming from the higher rate).

Increases in Corporation Tax are sensible ways to raise revenue, with the UK currently having a headline Corporation Tax rate below the global, OECD or EU averages (in 2019, the UK had the joint fourth-lowest headline Corporation Tax rate in the OECD: only Hungary, Ireland and Lithuania had lower rates).[3111] But it is noteworthy that the next few years will see companies facing very strong incentives to invest in plant and machinery in the two years with the `super deduction', followed by weaker incentives from April 2023 when the main Corporation Tax rate rises to 25 per cent. The OBR say that the higher Corporation Tax rate will lower investment and our national capital stock in the long-run. In reality, the incentive that businesses have to invest from April 2023 will also depend on the size of the annual investment allowance, something that has varied from £50,000 to £1 million over the past 13 years; we can expect the Treasury to return to this in future Budgets.

Freezing income tax thresholds

Because many tax thresholds are assumed by the OBR to rise in line with inflation each year, the Government can 'raise' tax revenue by freezing them in nominal terms. This makes freezes to tax thresholds a relatively easy (i.e. not visible) tax rise politically. Very sensibly, then, the Chancellor has included freezes in income tax allowances as part of his fiscal consolidation, raising £8 billion a year by 2025-26 (or £19 billion over the whole forecast period).[32]

Budget 2021 announced that, after rising with inflation in April 2021 to reach £12,570 and £50,270, the Income Tax personal allowance and the higher-rate threshold will then be frozen through to 2025-26.[33] Given forecasts for CPI, default uprating would have taken them to £13,540 and £54,340 by April 2025 respectively. This means a typical standard basic-rate tax payer will pay £194 a year more in tax in 2025-26 than if allowances had been uprated with inflation: someone between £54,340 and £100,000 would pay £1,008 more, and someone with income over £125,000 would pay £814 a year more (the amount is lower as anyone earning above £125,000 does not receive a personal allowance, and so is unaffected by it being frozen). Alongside these, there is also a freeze in the Upper Earning and Upper Profit Limits in the National Insurance contributions system (as they are aligned with the higher-rate threshold): these are the points at which the rate of employee and self-employed NICs falls, so freezes in these limits actually reduce NI contributions for those with earnings above £50,270.

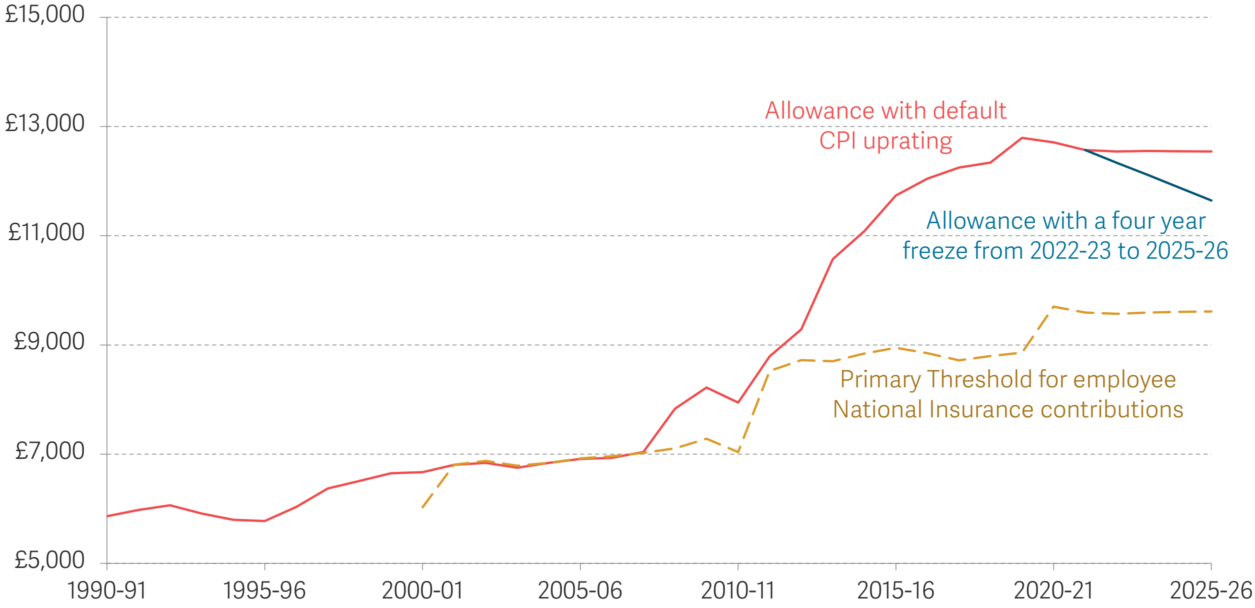
Figure 29 and Figure 30 show the real-terms value of these income tax thresholds over time (the slight real fall in these thresholds after 2021 under default uprating arises because inflation is rising over the period, and thresholds are indexed to a lagged measure of inflation). The personal allowance has increased considerably since 2010-11, and, even with a four-year freeze, it would still be 42 per cent higher in real-terms than the value in 2010-11, compared to 53 per cent without the freeze. The higher-rate threshold, however, has not seen a consistent path in the past two decades: it rose under Labour governments, fell sharply in the first years of the coalition government, but has been rising in real-terms in recent years.

32 There is a different higher-rate threshold in Scotland, and the Scottish Government has the power to implement a different income tax personal allowance from the one set by HM Treasury, but so far has not done so.

33 The higher-rate threshold does not actually exist: there is a personal allowance, which in some cases is increased or decreased, and then there is a band of income on which basic-rate tax is paid. We use the higher-rate threshold to refer to the sum of the personal allowance and this basic-rate limit. For a regular taxpayer with income below £100,000, any income above what we call the higher-rate threshold will be taxed at 40 percent.

FIGURE 29: **A frozen personal allowance would still be high in historical terms**

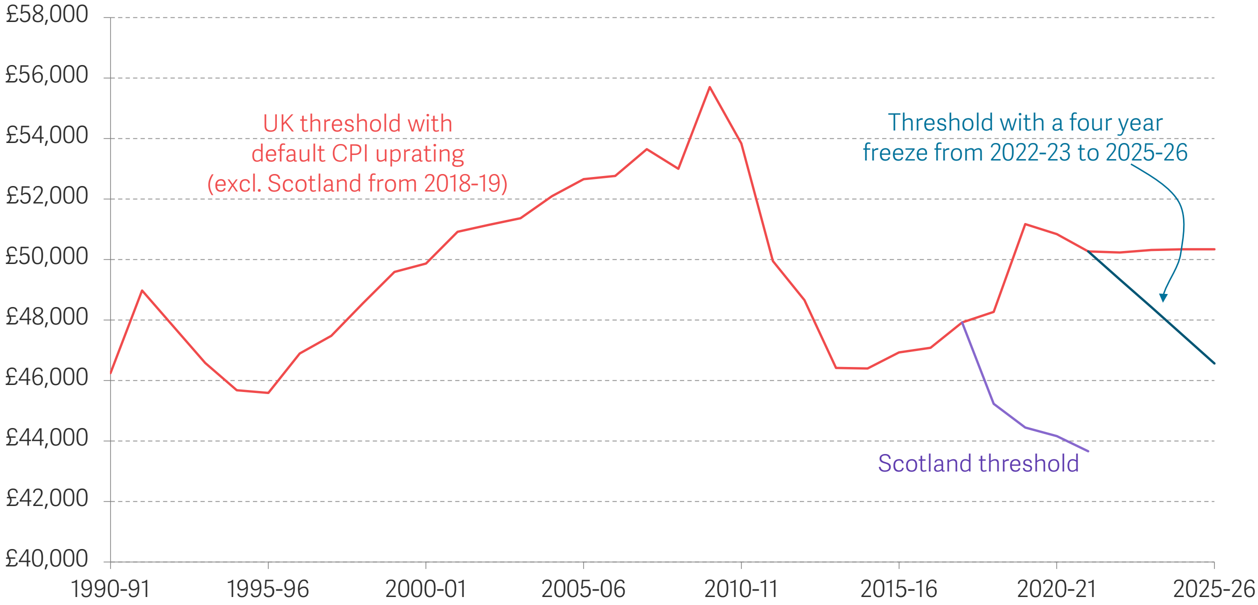
Income Tax personal allowance, in 2021-22 CPI adjusted prices: UK, 1990-91 to 2025-26



SOURCE: RF calculations based on HMRC; ONS, CPI; OBR, March 2021 EFO.

FIGURE 30: **The higher rate threshold for Income Tax has been volatile since the financial crisis**

Income Tax higher-rate threshold, in 2021-22 CPI adjusted prices: UK, 1990-91 to 2025-26



SOURCE: RF calculations based on HMRC; ONS, CPI; OBR, March 2021 EFO.

It was notable that little was said about the National Insurance contributions threshold in the Spring Budget: the Conservative election manifesto from 2019 professed an 'ambition' to raise it to £12,500, matching the then-level of the Income Tax (IT) personal allowance. We have previously estimated that increasing the threshold to £12,500 by the end of this parliament – a tax cut of roughly £300 per employee – would be very expensive, costing around £7 billion in 2024-25.[34] Very sensibly, then, not much was said about this and unless there is a very good case for doing so, the Government should avoid making its fiscal consolidation even harder by implementing permanent tax cuts of this nature.

Wealth and savings taxes

As well as freezing income tax allowances, the Chancellor announced multi-year freezes in other key thresholds that are relevant to the taxation of savings and wealth.

The Budget freezes the lifetime allowance that applies to tax-free savings into a pension pot until April 2026; this currently stands at £1,073,100. The lifetime allowance works in effect to limit the total amount of tax relief that well-off individuals can receive over their lifetime, as any savings made into a pension pot whose value exceeds the lifetime allowance do not attract tax relief. By freezing this limit, the Chancellor will therefore reduce slightly the amount of tax relief that is received by those whose pension pots exceed £1,073,100. The OBR estimates that this will raise £300 million a year by 2025-26. Similarly, all inheritance tax thresholds are to be frozen until April 2026 (raising £445 million a year by 2025-26), as is the annual exempt allowance in the Capital Gains Tax (this functions like a personal allowance in income tax), which will stay at £12,300 (raising just £30 million a year by 2025-26). The annual limit on ISAs and the band of savings income that is subject to a zero per cent rate are also frozen.

This broad approach to raising revenue is one that almost any Chancellor would take. In some cases, the policy is also actively desirable, such as the freeze to the inheritance tax thresholds. They will also help address the under-taxation of wealth, and at least avoid worsening the (undesirable) favourable tax treatment of capital gains compared with income. As a piece of tax reform, though, these measures side-step all of the structural flaws that have been identified about the way that we tax savings and wealth. Bolder reforms – as well as ones that could have made a greater contribution to the fiscal consolidation – would have included a cap on the amount that can be withdrawn as a tax-free lump-sum from pension pots; rolling out flat-rate pension contribution tax relief;

34 G Bangham et al., Unhealthy finances: How to support the economy today and repair the public finances tomorrow, The Resolution Foundation, November 2020.

moving to a more equal treatment of income and capital gains; and an end to some of the Capital Gains Tax and Inheritance Tax breaks that apply on death.[35]

But many duties were frozen too, representing a giveaway from the Exchequer

Despite his desire to reduce the deficit, the Chancellor decided to forego some revenue that was already pencilled in by announcing a one-year freeze in 2021-22 to various duties and other indirect taxes, including alcohol duties (costing him £350 million), fuel duties (£945 million) and various smaller taxes (such as the aggregates levy and HGV road user levy).

The freeze in fuel duties means that they are unchanged in nominal terms from their value in March 2011, still standing at 57.95p per litre of diesel or petrol. This will naturally lead to some to wonder just how green is the Budget, especially as little was said about continuing or improving the Green Homes grant. But the Budget did say that future fuel duty rates would be set in the light of the Government's commitment to reach net zero by 2050.

The increases in personal taxes are slanted towards better-off households

Figure 31 shows the distributional impact of the changes to Income Tax and National Insurance contributions thresholds across the whole population.[36]

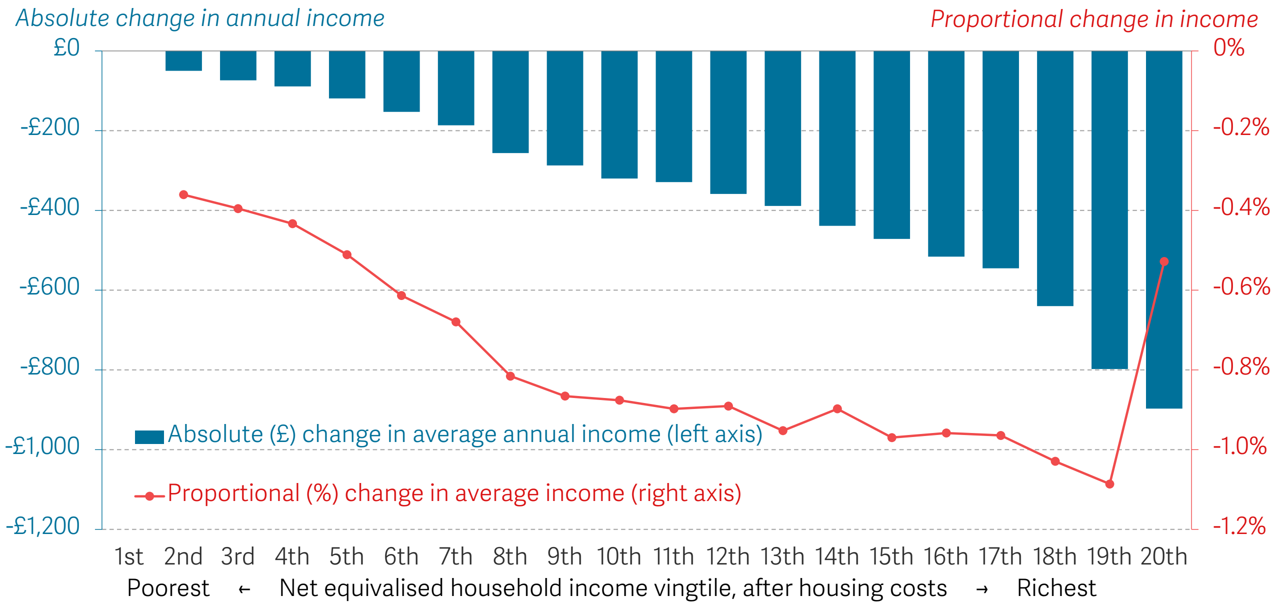
These freezes hit higher-income households more than lower-income households (the impact at the very top of the income distribution is muted because those above £125,000 do not receive a personal allowance and so are unaffected by it being frozen); this is mostly because anyone with a taxable income of less than £12,500 is unaffected. By 2025-26, the extra tax represents about 0.8 per cent of household income for the richest 20 per cent of individuals, who will be paying on average £720 per year more in tax. For the middle 20 per cent, the extra tax represents 0.9 per cent of their household income, or £324; and for the bottom 20 per cent, just 0.4 per cent, or £60per year.

35 Comprehensive proposals to reduce these issues can be found in: G Bangham et al., Unhealthy finances: How to support the economy today and repair the public finances tomorrow, The Resolution Foundation, November 2020, and The Resolution Foundation, A New Generational Contract: The final report of the Intergenerational Commission, May 2018.

36 Note this analysis focuses solely on income tax thresholds rather than the other freezes announced. The Treasury's distributional analysis of the Budget estimates that freezing the lifetime allowance for pensions tax relief will increase tax payments by an average of about £50 a year for households in the top income decile, representing 0.05 per cent of their income, with very small impacts also in deciles eight and nine. We have also not included the impact of the one-year freeze in various duties, which acts to boost households' disposable income; again, this is shown in the Treasury's own analysis (HM Treasury, Impact on households: distributional analysis to accompany Budget 2021, March 2021).

FIGURE 31: **Income tax threshold freezes are mostly progressive**

Impact on average household income by vingtile of freezing Income Tax thresholds for four years from 2021-22: 2025-26, UK



NOTES: We exclude the bottom 5 per cent, due to concerns about the reliability of data for this group. Personal Tax Allowance, higher rate threshold, and Upper Earnings/Profits Limit are modelled as frozen in cash terms from 2021-22 to 2025-26.
SOURCE: RF analysis of DWP, Family Resources Survey, using the IPPR tax-benefit model.

Although tax has occupied much of the attention at this Budget, the Chancellor pencilled in further cuts to day-to-day spending

We showed in Figure 12 that overall public spending is forecast to increase as a share of GDP relative to pre-pandemic levels, even after Covid-19 related expenditure has reduced to zero. Total Managed Expenditure is set to reach 41.9 per cent of GDP by the end of the forecast in 2025-26, up from 39.8 per cent in 2019-20.

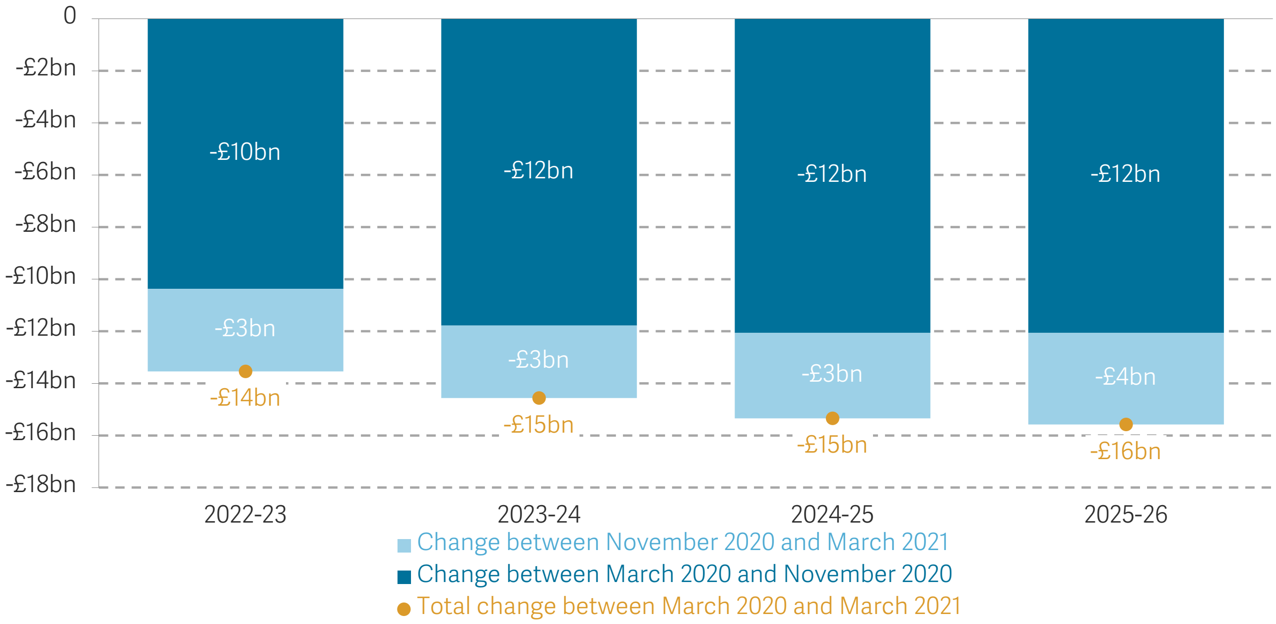
This medium-term increase in spending is not driven by Covid-19. Instead, it is a result of decisions largely taken before the pandemic hit. The first of these is a relatively large increase in underlying (non-Covid-19) day-to-day departmental spending (RDEL), of 3 per cent a year between 2019-20 and 2021-22.[37] This pushes RDEL up from 14.7 per cent of GDP in 2019-20 to 15.3 per cent of GDP in 2022-23.[38] Second, the Government's ambitious capital spending plans will increase CDEL (Capital Departmental Expenditure Limits) from 2.7 per cent of GDP in 2019-20 to 3.6 per cent of GDP by 2022-23 (see below for further discussion of capital spending plans).[39]

37 See Table 1.9 in: HM Treasury, Budget 2021, March 2021.
38 OBR, Economic and Fiscal Outlook, March 2021.
39 OBR, Economic and Fiscal Outlook, March 2021.

But what is set to happen after these increases have taken place is worthy of more attention than the Chancellor has given it to-date. This is because, at this Budget, the Chancellor has doubled down on his decision in November 2020 to pencil in lower totals for RDELs in the post-pandemic years. In November, he chose to reduce RDEL totals by up to £12 billion a year, and in this Budget he has gone further, with an additional £4 billion reduction. In fact, had he not done this debt as a share of GDP would not be falling in the OBR's forecasts. Overall, as Figure 33 shows, RDELs are now planned to be £15 billion a year lower in 2024-25 (in real terms, 2019-20 prices) than was planned before the pandemic.

FIGURE 32: **Compared with pre-pandemic plans, day-to-day spending is set to be £15 billion lower in 2024-25**

Changes in real (GDP-deflator adjusted) Resource Departmental Expenditure Limits since the March 2020 Budget



SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, November 2020 & March 2021; HM Treasury, Spending Review 2020, November 2020; HM Treasury, Budget 2021, March 2021.

This additional reduction is a justified by the Government on the basis of the lower GDP deflator (lower inflation). However, as the OBR points out, this makes little sense and is in effect saying that public spending in the mid-2020s is being reduced further as a result of the mechanical impact that the reduction in public services being delivered during the pandemic (e.g. a drop in education services because of school closures) is having on the GDP deflator.[40] In reality this appears to be a straight policy choice to further squeeze day to day public service spending, possibly in part to ensure debt is falling without further pressure to raise taxes.

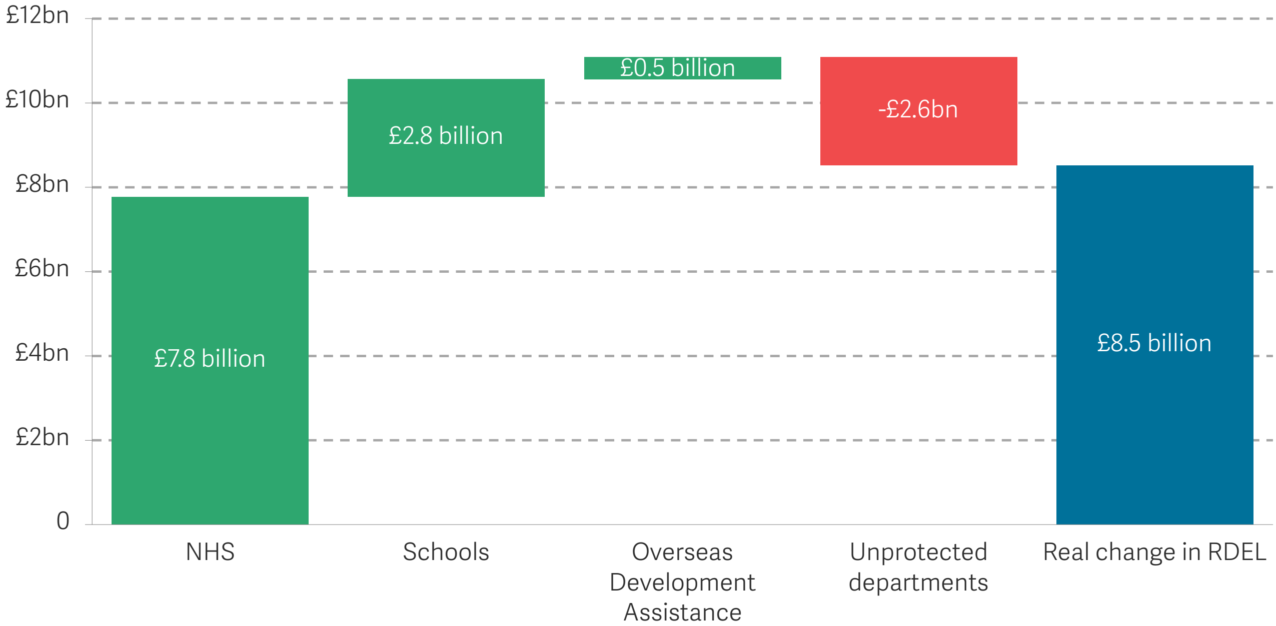
40 The OBR discusses this point in paragraph 3.78 in: OBR, Economic and Fiscal Outlook, March 2021.

The spending envelope for next year implies cuts to unprotected budgets in 2022-23

An important question, then, is whether or not this planned reduction in spending is achievable. There are a number of reasons why it might not be so. First, the Government is currently assuming that there will be no further Covid-19-related additional spending needs beyond 2021-22. This seems to discount any possibility of spending pressures arising from, for example, future decisions to improve capacity and resilience within the NHS, or the ongoing costs of annual Covid-19 vaccination programmes. Second, the broader pressures on public spending including the UK's ageing population and the transition to Net Zero are only likely to increase in the years ahead. Third, tight spending envelopes do not just imply small increases in departmental spending in mid-2020s, but actually imply cuts to unprotected departmental budgets given the commitments made in other areas.

FIGURE 33: **Unprotected departmental budgets will fall in real terms in 2022-23**

Real (GDP-deflator adjusted to 2019-20 prices) change in Resource Departmental Expenditure Limits: 2021-22 to 2022-23



NOTES: NHS and Schools budgets shown include Barnett consequentials of impact of increase in NHS England and English Schools budget commitments. ODA budget is assumed to grow in line with Gross National Income between 2021-22 and 2022-23.
SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, March 2021; HM Treasury, Budget 2021, March 2021.

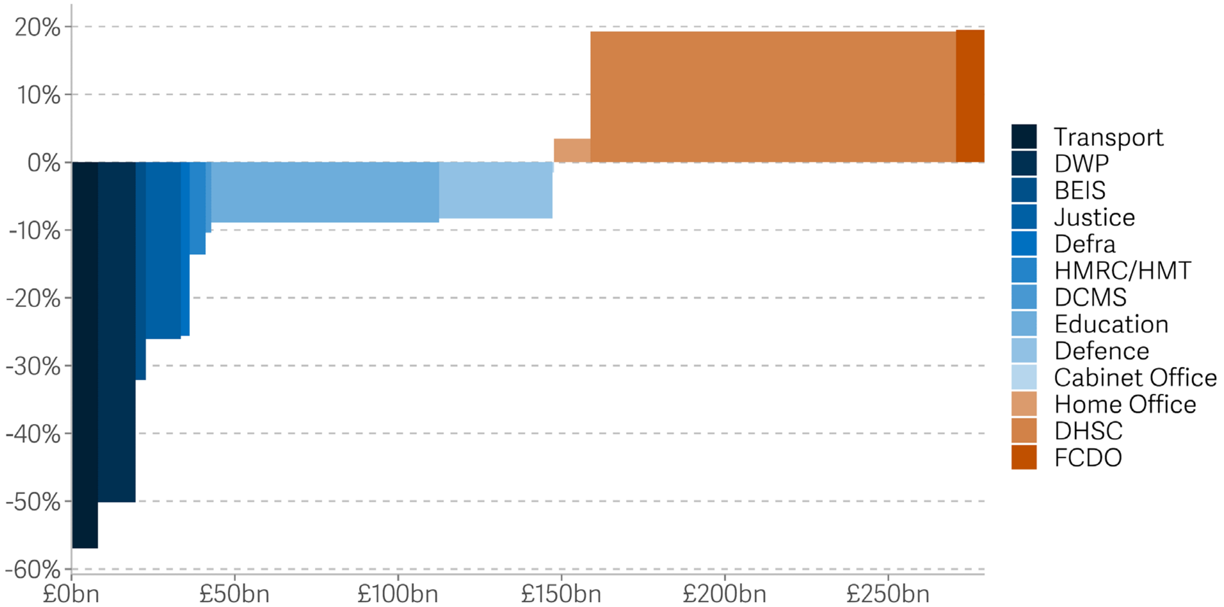
In particular, the large planned increases in Health and Education budgets (and the associated Barnett consequentials of these increases), as well as maintaining Overseas Development Assistance at 0.5 per cent of Gross National Income, will require an increase in real RDELs of £11 billion (in 2019-20 prices) between 2021-22 and 2022-23. But the Government is only planning an £8.5 billion increase in RDEL. This, then, implies a reduction in day-to-day spending in unprotected departments of £2.6 billion or 1.8 per cent (Figure 33).[41]

Future spending restraint comes on the back of a decade of austerity

A further reason why the £15 billion of lower than planned spending may be difficult to achieve is that they follow on from very large cuts to unprotected RDELs since 2009-10. It is just more difficult to cut spending from departments that have already absorbed significant reductions.

FIGURE 34: **Health and aid spending have grown significantly over the past decade, but some other departmental budgets have fallen by half**

Percentage change in real (GDP-deflator adjusted) RDEL spending, by department: 2009-10 to 2019-20



NOTES: Comparison of departmental spending levels shown adjusts as far as is possible for machinery of government and other related spending changes. Departmental RDELs in 2009-10 are shown along the x-axis.
SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, March 2021; HM Treasury, PESA tables, various.

Over the 10 years from 2009-10 to 2019-20 (before Covid-19 spending and Brexit spending both had significant impacts on RDEL budgets), some departmental budgets were cut by as much as a half. For example, the Department for Transport's RDEL budget fell by 57 per cent in real terms between 2009-10 and 2019-20, and the Department for Work and Pension's RDEL budget fell by 50 per cent over the same time period (see Figure 34).

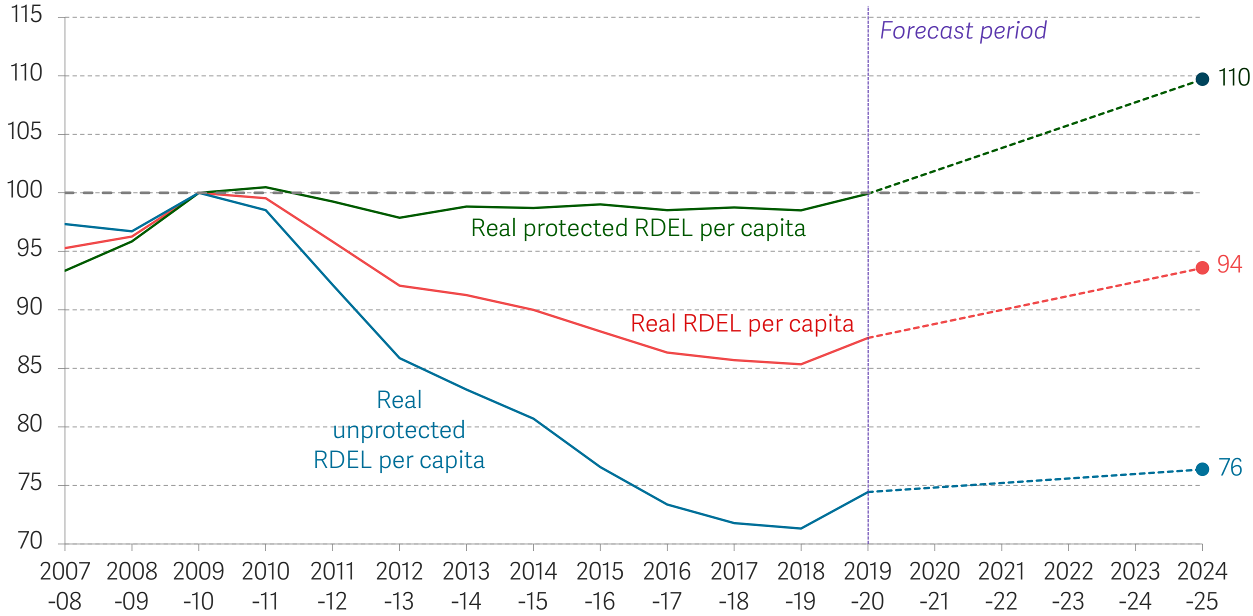
41 This is a slightly larger reduction than described in the OBR's March 2021 EFO primarily because the Barnett Consequentials of Health and Education spending increases have been included in 'protected' spending in this analysis, and the OBR has instead included them in 'unprotected' spending.

Over the 10 years from 2009-10 to 2019-20 (before Covid-19 spending and Brexit spending both had significant impacts on RDEL budgets), some departmental budgets were cut by as much as a half. For example, the Department for Transport's RDEL budget fell by 57 per cent in real terms between 2009-10 and 2019-20, and the Department for Work and Pension's RDEL budget fell by 50 per cent over the same time period (see Figure 34).

In assessing the deliverability of current spending totals, it is important to look below the level of overall aggregates to the implications for specific departments. For example, RDEL per capita is set to increase by 10 per cent over the period from 2019-20 to 2024-25, undoing more than half of the cuts made to RDELs between 2009-10 and 2018-19. But this, as has been the case since 2009-10, is driven by increases in spending on protected budgets such as the NHS (See Figure 35).

FIGURE 35: **While protected departments will see budgets return to pre-austerity form, unprotected departments will see little change**

Percentage change in real (GDP-deflator adjusted) RDEL spending, by department: 2009-10 to 2019-20



SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, March 2021; HM Treasury, PESA tables, various.

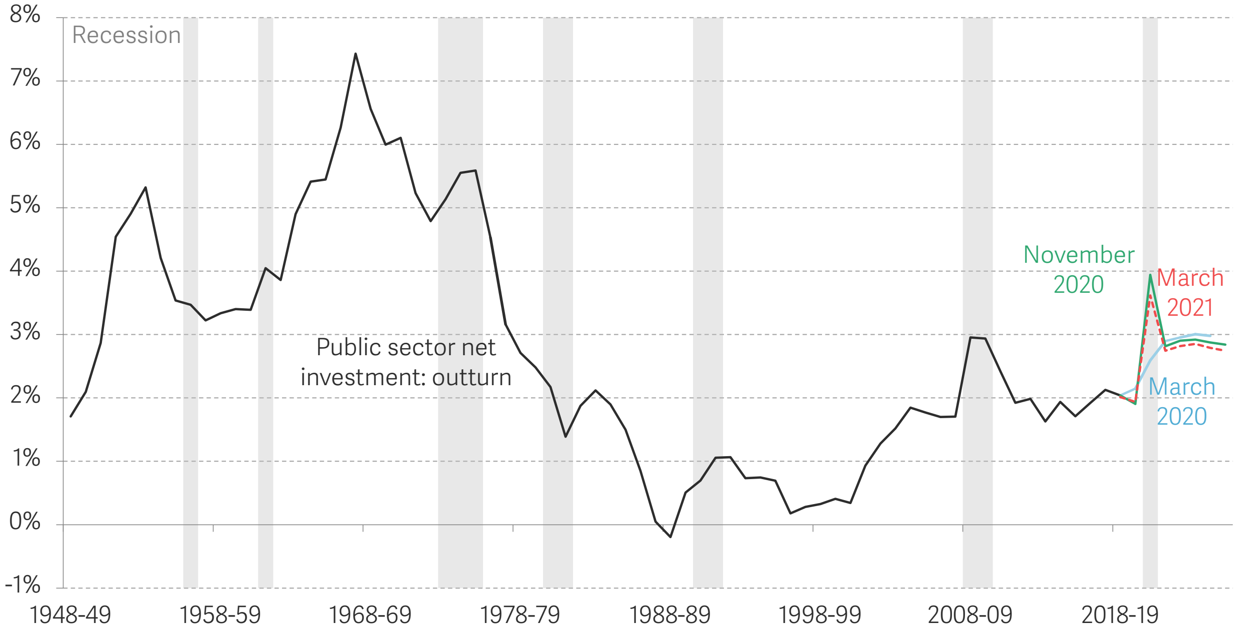
Although not falling in real terms per capita, as was the case between 2009-10 and 2018-19, unprotected departmental budgets are set to grow very slowly between 2019-20 and 2024-25 –by just 3 per cent in total over this five-year period. By 2024-25, real unprotected RDEL per capita will still be almost one-quarter lower than in 2009-10, with less than one-fifth of the reduction in spending between 2009-10 and 2018-19 having been unwound. For much of Whitehall, although austerity is over in so far as very large reductions in spending have ceased, the level of spending will remain broadly similar to its post-Osborne-era level.

Public service spending pressures stand in stark contrast to significant capital spending commitments

Although resource spending budgets have been tightened even further at this Budget, the Chancellor continued to stand by the significant uplift in capital spending announced in March 2020. As shown in Figure 36, this means that public sector net investment will average around three per cent of GDP from 2021-22 onwards. The significant spike in net investment in 2020-21 largely relates to the write-offs from the Government's loan schemes (recorded as capital transfers at the point the guarantee is issued), which add over £27 billion to capital spending from existing loan schemes, as well as the new 'Recovery Loan Scheme' announced in Budget 2021.

FIGURE 36: **Budget 2020 public investment plans have been maintained, at around 3 per cent of GDP**

Public sector net investment as a proportion of GDP, outturn and successive forecasts: UK, 1948-49 to 2025-26



SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, November 2020 and March 2021.

Investing at around three per cent of GDP would represent the highest levels of sustained capital spending since the late 1970s, which is welcome to reverse decades of underinvestment, and to address the significant challenges ahead that are likely to require sustained capital investment, such as the Government's levelling up agenda and the path to reach Net Zero by 2050.[42] The key news in this Budget was not new funding – unsurprising, given the significant levels of capital spend already committed – but

42 See: A Bailey, R Hughes, L Judge & C Pacitti, Euston, we have a problem: Is Britain ready for an infrastructure revolution?, Resolution Foundation, March 2020

more detail on where this funding will be spent. The majority of these reflect 'green' and levelling up priorities, including further detail on the 'crowding-in' of private investment through the UK Infrastructure Bank for green investment, as well as the acceleration of City and Growth Deals in Scotland and Wales.

However, although investment in these areas is welcome, the Chancellor has leaned heavily on the premise that this capital spending is at the heart of the fiscal 'stimulus' provided by the Government, with the Budget stating that: 'public investment is a significant part of the government's economic and fiscal strategy and will contribute to productivity growth', and including March 2020 increases in capital spending in total calculations of fiscal support.[43] This is perhaps at odds with some of the commitments set out above, particularly in terms of levelling up. The highly political basis on which capital spending is likely to be allocated, such as through the 45 New Towns Deals announced, could limit its effectiveness as a fiscal stimulus. This does not mean to say that this capital investment is not necessary, or beneficial, but that it might have lower macroeconomic benefits than capital spending allocated with fiscal multipliers explicitly in mind.

And commitments amounting to over £300 billion in real terms over the five years could pose a challenge in terms of future consolidation, depending on the fiscal framework adopted. The falls in public sector net investment following recession periods (outlined in Figure 36) show that cuts into capital budgets have often been the least 'painful' option for Chancellors looking to cut the deficit and set debt on a downward trajectory. And, as set out above, tight margins on resource spending may make the capital spending budget the Chancellor's biggest margin for any future cuts to spending. The fiscal tightening announced in the Budget means that the current balance (the balance between day-to-day spending and revenues) stands at just 0.1 per cent of GDP by 2025-26, with the whole of the nearly three per cent of GDP overall deficit accounted for by capital spending.

However, the likelihood that the Chancellor can deliver these ambitious capital spending plans over the medium term will depend on the fiscal framework chosen, as well as the path of the recovery, and spending pressures in the years ahead. Despite the nearly three per cent of GDP deficit, debt (excluding the Bank of England) is still falling by the end of the forecast. The 'debt-stabilising' level of borrowing is largely a factor of interest rates and GDP growth. Although GDP growth remains low by historical standards, even lower interest rates means that debt falls absent further borrowing – and around three per cent of GDP in borrowing can be maintained with debt still falling – covering the capital spending commitments. However, if interest rates become higher, this is

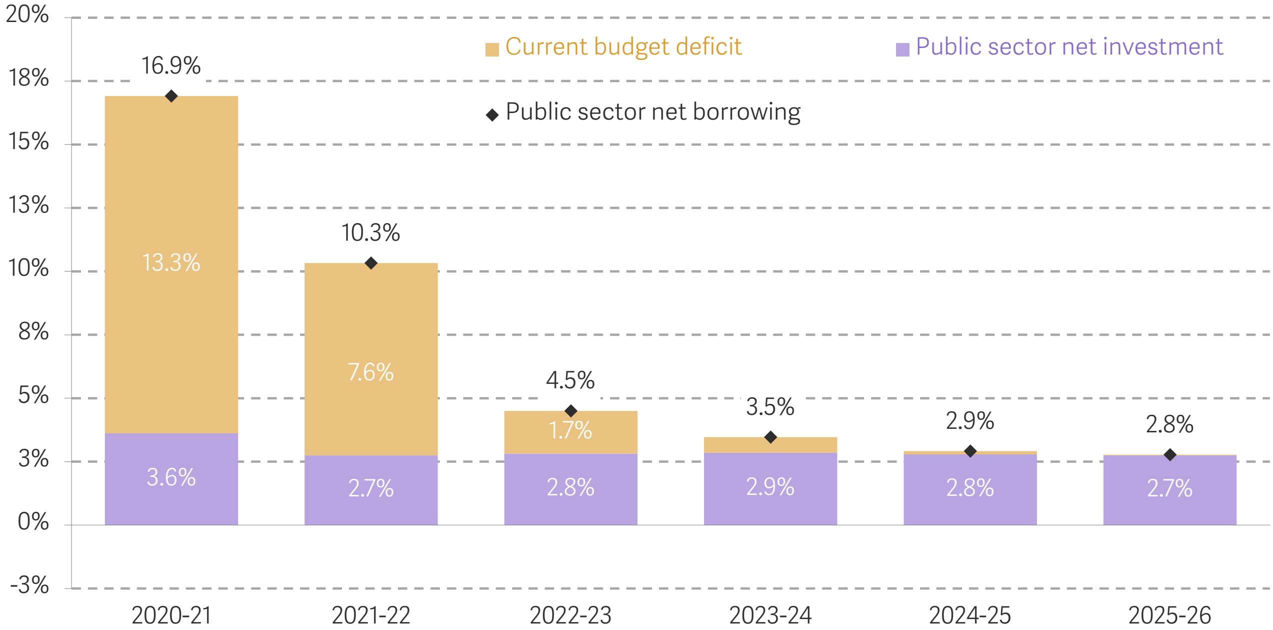
43 See p23 in HM Treasury, Budget 2021, March 2021.

unlikely to remain the case; if this happened, then, to keep debt falling, or to deal with other downside news in terms of the economy, or upward pressures on day to day public service spending, the Chancellor may face pressure to make cuts to capital spending in future.

FIGURE 37: **Investment spending makes up the entire deficit by the end of the forecast**

Public sector net investment, current budget deficit and public sector net borrowing, as a proportion of GDP: UK, 2020-21 to 2025-26

SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, March 2021.



The Chancellor has risen to his three policy challenges, but will need to be ready to do more

Faced with the largest fall in GDP in more than 300 years and unprecedented peace-time borrowing, the Chancellor has set out additional measures to protect families and firms through the difficult months ahead, provided significant additional stimulus to boost the recovery, and making much larger progress on repairing the public finances than expected.

The extension of crisis support measures was largely as expected. The continuation of the JRS and SEISS was heavily trailed into the run-up to the Budget, but tapering these schemes to September and reforming the self-employment scheme are a significant step towards minimising the impact of the remaining months of social-distancing restrictions on the labour market. Meanwhile, additional grants for firms should help those in the hardest-hit sectors that have seen their cash levels depleted. Significant uncertainty remains about the path out of the pandemic – not least the extent to which new variants will mean that restrictions need to be in place for longer – and further support will be needed. For this reason, the tapering of support should be tied to progress on the health crisis.

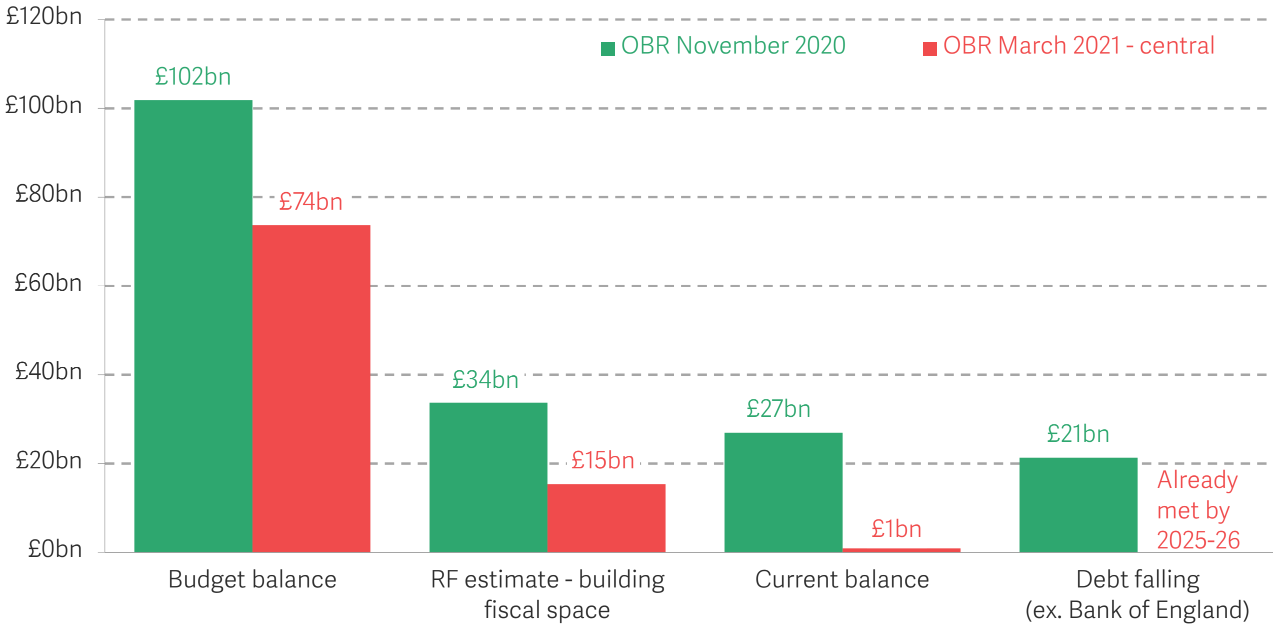
The Chancellor surprised on the upside in terms of the overall level of policy boost to support a rapid recovery. With much of the pre-Budget debate focussing on how to phase out support and start raising taxes, expectations for additional stimulus to drive a rapid recovery were low. In the event, the Chancellor announced around £67 billion in new measures over the next two years. Although this was well below the £100 billion of additional stimulus called for in our previous work, it is still a substantial policy boost to the economy. Based on the OBR's updated economic assessment, around £20 billion more would be needed to close the output gap over the next two years. The support that was announced was skewed towards boosting firms' demand. Although active measures to increase business investment after a prolonged period of weakness is welcome, the Chancellor is relying on a smooth exit from social distancing restrictions to deliver a sharp increase in household consumption and a sharp fall in unemployment. If such optimism proves misplaced, more stimulus focused on supporting household incomes will be needed.

Finally, on progress towards repairing the public finances, the Chancellor has taken very big steps forward. The largest increase in taxes since 1993 is sufficient to put debt on a falling path and close the current deficit by 2025-26. But these are not the only metrics for how much repair is needed. As shown in Figure 38, the Chancellor would need to do far more tightening – around £74 billion – in order to achieve a balanced budget that at least one previous Conservative Chancellor has advocated. More realistically, in an era where fiscal policy is required to be more active during recessions it is also important to build more fiscal space in between recessions – suggesting a reduction in the debt-to-GDP ratio of around 25 per cent as a prudent target based on historical experience. Putting the public finances on a trajectory to achieve that would require another £15 billion of fiscal tightening. So there is an argument that further tightening may well be necessary based on where we are today.

There are also significant risks around the extent of the necessary repair to the public finances which are tilted towards the need to do more. For example, the Bank of England's more optimistic outlook for the economy – particularly the lower estimate for the extent of longer-term economic scarring – would suggest it would be possible to run looser fiscal policy while still putting debt on a downward trajectory in the medium term. To the downside, additional tightening will be required in the not unlikely event that some Covid-19 related activities becomes semi-permanent, or that the lasting economic impact is larger in line with other recent recessions. Perhaps most obviously, stabilising debt on a year to year basis while running a budget deficit is highly dependent on low interest rates continuing. If any of these risks were to crystallise, the Chancellor would face the difficult choice of more substantial tax rises or scaling back his ambitious public investment plans.

FIGURE 38: **Under current forecasts, the need for further consolidation in the medium-term has been significantly reduced**

Fiscal consolidation required in 2025-26 under various metrics (2025-26 prices), November 2020 and March 2021 forecasts: UK, 2025-26



NOTES: 'RF estimate - building fiscal space' refers to the consolidation needed to reach the level of the current balance that would be required on average, over the next six years, to build 25 per cent of GDP in fiscal space in net worth terms (i.e. excluding investment spending). For more details see Section 2 in: G Bangham, A Corlett, J Leslie, C Pacitti & J Smith, Unhealthy finances: How to support the economy today and repair the public finances tomorrow, Resolution Foundation, November 2020.
SOURCE: RF analysis of OBR; Economic and Fiscal Outlook, November 2020 and March 2021.

Overall, then, while the Chancellor has been nimble enough to find a way to support the economy in the near term, and also begin the process of repairing the longer-term damage to the public finances, significant challenges remain. With huge uncertainty clouding the outlook, this approach will need to continue to respond to changes in the economy and the path of the health crisis.

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