The Boris Budget

Resolution Foundation analysis of Autumn Budget and Spending Review 2021

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Summary

This was a big Budget and, despite being delivered by Rishi Sunak, a Boris Budget: promising more spending and higher wages. It partially delivered on the former, but good public finance news could not hide a grim reality ahead for household finances.

A bigger economy now, a lower estimate for the permanent economic hit from the pandemic, and higher inflation all meant that the Office for Budget Responsibility (OBR) could hand the Chancellor a large windfall, with borrowing down by a cumulative £141 billion over the next four years. This is driven largely by higher tax receipts which the OBR expects to be permanent.

That same higher inflation has a much less positive impact on households though, with real wage and income growth set to grind to a halt next year. Living standards stagnation remains the dominant feature of this era: in the 16 years leading up to 2008, average earnings grew by 36 per cent; in the 16 years following 2008, real wages are forecast to have risen by just 2.4 per cent in total. The country is still in the weakest decade for pay growth since the 1930s.

The Chancellor used half his Budget windfall to keep his boss happy by increasing spending, and the other half to keep the Treasury happy with faster falls in borrowing and debt. Spending increases were focused on the next two years, in part to help departments with higher inflation and ongoing Covid-related costs. Future years’ rises are smaller and concentrated on partially reversing decisions Rishi Sunak himself had made on public services and on Universal Credit. Together, they will take spending to its highest share of GDP outside of recessions since the early 1980s.

In 2024-25, over two-fifths of the £12 billion increase in day-to-day public service spending will go on reversing the cut to overseas aid. The remaining increase will prevent rising NHS spending leading to further cuts for unprotected departments. But although austerity in terms of falling departmental spending is certainly over, its effects will live on: even after a Spending Review where almost every department sees real-terms growth, only one-third of the post-2010 cuts to unprotected departments real terms per person spending will be reversed by 2024-25. Day-to-day spending in Work and Pensions and Transport, for example, will be down by an inflation-adjusted 40 per cent and 32 per cent respectively on 2009-10 levels. By contrast, the ongoing prioritisation of Health and Social Care spending will mean that, by 2024-25, the department will have received a staggering £84 billion of the £111 billion a year increase in Whitehall-controlled day-to-day departmental spending since 2009-10. As a result, it will account for 46 per cent of such spending, up from 34 per cent in 2009-10.
The Chancellor also set out allocations for the long-planned higher capital spending promised in the 2019 election. Capital spending is set to rise by nearly 50 per cent in real terms by the end of the forecast compared to 2019-20, making this the first recession not to be followed by cuts to government investment since the 1960s. The shape of capital spending has also changed since its last peak in 2009-10, reflecting new priorities on science, net zero and levelling up. Business and Transport departments are the big winners, accounting for nearly two-in-every-five (37 per cent) pounds of investment by 2024-25, compared with slightly more than one-in-five (23 per cent) in 2010-11. At the other end of the spectrum, Education has seen its share of capital spending fall by nearly two-thirds, to just 5 per cent.

The Chancellor’s answer to this winter’s cost of living crunch was a significant and welcome increase to the generosity of Universal Credit (UC) for working households. The move to ensure that those on the benefit can keep significantly more of each extra pound earned, and raising the amount that households with children can earn before their benefits start to be reduced, will cost around £3 billion by the end of the forecast period.

For some, this change will be significant: a family with two adults in work (one working full-time with earnings at the 25th wage percentile and one working part-time on the National Living Wage for 20 hours a week), who have two children, will gain £42 a week from these Budget day changes, more than offsetting the £20 per week reduction made to the benefit earlier this month. But, overall, these changes will be overshadowed by last month’s £6 billion cut to entitlement: three-quarters of families on UC will lose more from the £20 cut than they gain from the Budget changes. Even if we also take into account the impact of the faster-than-average-earnings increase to the National Living Wage, the poorest fifth of households will still be an average of £280 a year worse off overall.

The Government is squaring the circle of a smaller economy post-pandemic but also planning to spend slightly more with big tax rises. Small tax cuts were announced today, including business rate discounts, a lower ‘bank surcharge’, reduced alcohol duty and (yet another) fuel duty freeze, but the big picture is of fast-rising receipts. National insurance and Income Tax rises kick in next April, while Corporation Tax will rise from 19 per cent to 25 per cent the following year. By 2026-27, tax as a share of the economy will be at its highest level since 1950 (36.2 per cent), amounting to an increase per household since Boris Johnson became Prime Minister of around £3,000. Higher taxes will largely fall on middle- and higher-income households. The combined impact of policies announced by Rishi Sunak since becoming Chancellor will, next April, deliver a 2.9 per cent income boost to the poorest fifth of households, 0.4 per cent income loss to middle-income households and a bigger 1.5 per cent loss for the richest fifth of households. By the
middle of the decade, after four years of the income tax threshold freeze, the Chancellor’s policies will have delivered a bigger income hit of 2 per cent to middle-income households, and a 3.1 per cent hit to the richest fifth of households.

The impact of front-loading spending increases and banking lower borrowing later on is that the Chancellor has, rightly, shifted fiscal policy to be more supportive of the recovery in the near term. He will hit his new fiscal rules in the medium term, with debt falling from 2024-25 and a current budget surplus of £25 billion in that year. The Treasury, as well as the Prime Minister, may therefore feel like they have got what they wanted from the Chancellor’s ‘spend big today but reduce debt tomorrow’ Budget. But the headroom against the Chancellor’s debt rule stands at 0.6 per cent of GDP, less than the headroom of three of the four fiscal rule regimes between 2010 and 2016 when they were introduced. With significant uncertainty from the pandemic, inflation and the global economy, the Chancellor may have to make more difficult trade-offs between the priorities of his boss and department in the years ahead.

A ‘Boris Budget’ means more tax and spend. This may sit oddly with a Chancellor who said in his Budget speech that his “goal is to reduce taxes”. But it should not be a surprise given that he is trying to combine fiscal conservatism with an ageing society and stubbornly slow-growing economy. Low tax conservatism it is not what the Government has in store for post-pandemic Britain.

The economic outlook has improved since the last Budget

In this briefing note, we discuss the key decisions taken at both the Autumn Budget and Spending Review 2021. Because the state of the economy should be the key determinant of those decisions, we start with the OBR’s updated projections, and the outlook for people and living standards. We then discuss the outcome of the Spending Review, before turning to what this means for the fiscal position and the Chancellor’s new proposed fiscal rules.

Record upgrades to the OBR’s growth forecast have made the Chancellor’s life easier

The economic starting point for this Budget was significantly better than expected in March 2021. As shown in Figure 1, GDP in Q2 2021 was 3.7 per cent above the forecast in March. The vast majority of this reflects a smaller economic hit from social distancing restrictions in the first half of 2021, and a more rapid recovery thereafter. Indeed, the UK’s GDP growth in Q2 2021 was the fastest among the G7, as social distancing restrictions
were lifted more rapidly than in any of those other countries. GDP growth this year is now expected to be 6.5 per cent, which would be the fastest growth in nearly half a century.

FIGURE 1: The economy looks set to be much stronger than projected in March 2021
Quarterly real GDP, outturns and select forecasts: UK

As a result, the OBR has increased its forecast for GDP growth in 2021 by 2.5 percentage points: this is the largest mark-up to current year growth in nearly 40 years of fiscal forecasting. As shown in Figure 2, this brings the OBR close to the forecasts made by the Bank of England, and within the range of forecasts made by members of HMT’s panel of independent forecasters, having previously been somewhat more pessimistic than the Bank of England through much of the pandemic.

1 Sources: OECD, Quarterly GDP; Oxford COVID-19 Government Response Tracker, Blavatnik School of Government, University of Oxford, updated 14 October.

2 Source: OBR, Historical official forecasts database.
Despite the better starting point, the near-term economic outlook remains uncertain

Despite this undoubted good news, there is significant uncertainty about the near-term path for the economy. GDP growth in July and August was just 0.3 per cent, a sharp slowing from 5 per cent in March and April. And, looking ahead, a range of near-term indicators suggest little acceleration in growth in September and October. Much of this is due to supply disruption. This is consistent with the OBR’s forecast for the second half the year, in which growth moderates in the autumn. Looking ahead, with Covid-19 cases remaining high, it is clear that the pandemic is far from over. As we discuss below, this apparent stalling of the recovery and risks of a further deterioration in the outlook provides the key motivation for providing more support to the economy.

Looking further ahead, reduced ‘scarring’ has provided a further boost to the Chancellor but the outlook is uncertain here too

As well as getting more optimistic about the near-term, the OBR is more positive about the medium-term outlook too. This translates into a reduction in its assumed medium-term ‘scarring’ from Covid-19. As shown in Figure 3, the OBR has reduced its estimate of the extent to which the economy will be smaller in the longer term from 3 per cent to 2

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3 Source: ONS, GDP monthly estimate.

4 For a full discussion of the latest data, see: J Leslie et al., The Uncertainty Principle: Previewing the decisions to be taken at the Autumn Budget and Spending Review 2021, Resolution Foundation, October 2021.
per cent. The most obvious area of upgrade since March is in the labour market where unemployment has risen by much less than expected in the spring (unemployment is now expected to peak at 5.2 per cent rather than the 6.5 per cent assumption in March). But the key change is to total factor productivity (TFP), a measure of economic efficiency that accounts for physical capital. The OBR cited a range of positive developments – including better news on intangible investment (such as R&D spending) and a pandemic-driven acceleration in the adoption of new ways of working – to justify reducing its assumed longer-term reduction in TFP from 1.2 per cent to 0.6 per cent. The OBR has also reduced its estimates of scarring on investment (referred to as ‘capital shallowing’) and labour market participation on the back of positive data developments. One element of scarring that is assumed to be larger is on the size of the working population: here the OBR have increased its estimate for the impact of the pandemic from 0.2 per cent to 0.4 per cent, mainly reflecting lower net inward migration.

**FIGURE 3: The OBR has reduced its ‘scarring’ estimate**

Contributions to the OBR’s assumed pandemic-related economic scarring

![Diagram showing contributions to OBR's assumed pandemic-related economic scarring](image)

**SOURCE:** OBR, Economic and Fiscal Outlook, March 2021 and October 2021.

At this stage in the recovery, of course, it is impossible to know what the eventual impact of the pandemic will be. This is partly because the eventual impact will depend on the extent to which changes in behaviour – such as the adoption of new ways of working – last beyond the crisis. But it is also because the extent of scarring will depend on how successful the Government is in using fiscal policy to drive a rapid recovery (for example, firms will invest more if they are more optimistic about the recovery). So, here, again the...

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5 For a longer discussion, see: J Leslie et al., *The Uncertainty Principle: Previewing the decisions to be taken at the Autumn Budget and Spending Review 2021*, Resolution Foundation, October 2021.
outlook remains unusually uncertain, providing key context for the Chancellor’s fiscal policy decisions. By way of context, the OBR is now expecting the lasting impact of the pandemic in terms of lower GDP to be half the size of their estimate of the long-run impact of Brexit.6

The living standards outlook looks weak

The labour market is much stronger than expected, but the end of the furlough scheme may still see unemployment rise in the short-term

Along with the OBR’s stronger economic outlook comes a stronger outlook for employment. The OBR now expects unemployment to peak at 5.2 per cent (in the last quarter of 2021, following the end of the Job Retention Scheme), compared to a peak of 6.5 per cent forecast in March (see Figure 4). Previous improvements in the employment outlook have followed extensions of the furlough scheme; this time the improvement is driven by the stronger-than-expected recovery and by positive labour market data since March: unemployment has been falling since the turn of the year, and the end of the furlough scheme in October has not triggered a rise in redundancies.7

6 See: Impact of the Brexit trade agreement on our economy forecast, OBR, March 2021.
7 BBC News, Planned Job Cuts Fall Despite Furlough Deadline, 7 September 2021.
Unemployment is expected to fall from 2022 onwards, reaching 4.2 per cent in 2023. This is marginally higher than the OBR’s pre-crisis view of the structural unemployment rate (4.1 per cent), reflecting some amount of geographic and sectoral mismatch in the labour market.

However, unlike unemployment, the record upgrade to GDP does not feed through to a significantly improved outlook for real wages, which remains poor (see Figure 5). In the short-term, the OBR expects real wages will fall: in 2022 they expect growth in average earnings of 3.9 per cent, and CPI inflation of 4.0 per cent.

Clearly, the OBR do not yet see evidence of a new economic model of fast real wage growth emerging from this crisis. Moreover, low real-terms pay growth has been a constant feature of the UK’s economy since the financial crisis. In the 16 years leading up to 2008, average earnings (on a national accounts-based measure) grew by 36 per cent; by 2024 (i.e. 16 years following 2008), the OBR expect real wages to have risen by just 2.4 per cent in total. As a result, decade-on-decade growth in real pay is at its lowest point since the 1930s. Reflecting this experience, the OBR has been becoming steadily more pessimistic over the past 10 years of undertaking these forecasts. In 2010 and 2011, its long-term outlook for real pay growth (i.e. ignoring the ups and downs of the business cycle) was 2.5 per cent per year; in the latest forecast, this long-term outlook has dropped to 1.5 per cent.

In contrast to sluggish growth in average wages, low earners have in general fared better thanks to the minimum wage rising faster than averages wages. In the twenty years from 1998 to 2018, real hourly wage growth has averaged above 1.5 per cent for the bottom one-tenth of earners, compared to below 1 per cent for those in the middle of the distribution. In keeping with fast rises in the minimum wage since 2016, 2022 will see the adult-rate minimum wage rise by 59p, an increase of 6.6 per cent. Box 1 provides an update on minimum wage policy.

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8 This measure of average earnings takes total employee compensation (ONS series DTWM) less employers’ social security contributions (ONS series ROYK), divided by the number of employees. This is used here because there is a longer time series available than in the Average Weekly Earnings dataset, which starts in 2000.

9 This calculation compares the average of CPI-adjusted pay over the last ten years compared to the average in the previous ten years. See: T Bell et al, The UK’s decisive decade: The launch report of The Economy 2030 Inquiry, Resolution Foundation.

FIGURE 5: Despite an upgrade to GDP, the pay outlook continues to be poor

Average weekly earnings, adjusted for CPIH inflation (2021 prices), outturn and OBR projection: UK

Notes: Average weekly earnings series is whole economy average, regular pay (i.e. excludes bonuses), adjusted for CPIH inflation. Projections apply the OBR's forecast of average earnings and CPI inflation to create an inflation adjusted pay series, which is then used to extrapolate from AWE.
Source: ONS, Average Weekly Earnings; OBR, Economic and Fiscal Outlook, various.

BOX 1: The national living wage is set to rise by 6.6 per cent from April 2022

On the eve of the budget, the Government announced that the National Living Wage (NLW, the minimum wage applying to adults aged 23 or over) would rise to £9.50 in April 2022, a 6.6 per cent increase on its current level. This follows a cautious uprating last year (of 2.2 per cent), when the Low Pay Commission (LPC), who advise the Government on minimum wage policy, judged that the fragility of the labour market precluded anything more ambitious. But although this year’s increase is large in cash terms (the biggest on record), inflation is high and rising, so in real terms the increase is not so large. The OBR expect CPI inflation to be 4.4 per cent next April, so the 6.6 per cent uprating will be a 2.2 per cent wage increase in real terms, fairly typical of what we have seen since 2016.

The NLW is currently being set in the light of the Government’s target for it to reach two-thirds of median hourly pay (among the relevant age group) by 2024. The impact of the furlough scheme on wage data means it is hard to judge exactly where the NLW is on this path. Figure 6 makes a best guess with the available data, and finds that last year’s cautious uprating is likely to have left
the minimum wage below its 2020-24 target trajectory, while this year’s higher uprating is likely to have pushed it above its target path.

FIGURE 6: A large increase in the minimum wage puts it back on its target path

‘Bite’ of the adult rate minimum wage compared to median hourly pay of the age group covered, actual, estimated, and target path: UK


It was also announced that the minimum wage for 21-22 year olds will rise by 9.8 per cent, somewhat faster than the adult rate; this may be part of a move to reduce the jump in wages when this age group, under current plans, become eligible for the adult rate in 2024.

But higher inflation will be a headwind to families’ spending power

The sting in the tail to the improved economic outlook is higher inflation. As shown in Figure 7, the OBR has increased its forecast for inflation very significantly: CPI inflation is now set to rise to 4.4 per cent in 2022, more than double the peak in its March forecast (1.9 per cent). The increase in the inflation forecast for 2022 is comfortably the largest...
such forecast revision in the OBR’s history (the OBR also noted that data that became available since it closed the forecast is consistent with inflation rising to 5 per cent).\textsuperscript{11}

\textbf{FIGURE 7: Inflation is set to be much higher than the OBR expected in March}

Outturns and forecasts for 12-month CPI inflation: UK

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{inflation_graph.png}
\caption{Inflation is set to be much higher than the OBR expected in March}
\end{figure}

\textit{SOURCE: RF analysis of ONS; OBR, Economic and Fiscal Outlook, March 2021 and October 2021; Bank of England, Monetary Policy Report, August 2021.}

The result is continued poor prospects for household incomes

The worsened outlook for inflation means household incomes are grinding to a halt (see Figure 8). The OBR expects average real household disposable incomes to fall 1.7 per cent in the second half of 2021, and income growth to be slow thereafter, with it taking until 2023 for average household incomes to recover to their level of 2021 Q2. 2022 growth has been revised down from 1.1 per cent to 0.0 per cent.\textsuperscript{12} Longer-term, although the outlook for the rate of growth of household incomes is roughly unchanged from the OBR’s pre-crisis forecast (it is now 1.3 per cent, compared to 1.4 per cent in the March 2020 forecast), the crisis is expected to have a lasting impact of -2.6 per cent on the level of household incomes.

\textsuperscript{11} For a discussion of the factors driving higher inflation, see: J Smith, Macroeconomic Policy Outlook Q2 2021, Resolution Foundation, June 2021.

\textsuperscript{12} Growth in 2021 is expected to be higher than was forecast in March, with the starting point for 2020 also revised up. This means 2022 income levels are expected to be only around 0.1 per cent down on 2019 levels, whereas in March they were expected to be 0.5 per cent down.
FIGURE 8: Household disposable incomes are set to fall in the second half of 2021
Real household disposable income per capita, outturn and selected OBR forecasts, 2008 = 100: UK

Just as with real wages, this weak outlook compounds what has been a dismal decade for living standards as hoped-for improvements in productivity growth have failed to materialise. To illustrate this, Figure 9 shows the end-of-horizon forecast for growth in real household incomes in successive OBR forecast rounds (with a five-year horizon, this should capture the OBR’s views of the potential for long-run income growth rather than the effects of the business cycle).

This shows that in the ten years in which the OBR has been producing forecasts, it has become steadily more pessimistic: in November 2011, in the aftermath of the financial crisis, the OBR thought long-run incomes growth would be 2.5 per cent – almost twice the 1.3 per cent that it now expects.
The impact of forthcoming policy changes is mixed across the income distribution

The Chancellor announced several measures in the Budget that were portrayed as a way to help households through the period of high inflation. These include freezes to duties on alcohol and fuel (costing the Government just over £2 billion in 2022-23), the increase to the National Living Wage (discussed above), and giveaways through Universal Credit, costing £2.2 billion in 2022-23 (see Box 2 for a discussion).

### Box 2: Budget changes to Universal Credit

The Budget changed two parts of UC:
- it increased work allowances by £500 a year, and reduced the taper in UC from 63 per cent to 55 per cent. Both mean that UC is withdrawn more slowly as people’s earnings increase. Both policies benefit UC recipients who are in work and earning more than their work allowance (if they have one).
- Although 2.2 million people in families receiving UC are in work, 3.6 million people are not in work, either because they are unemployed and searching for work, or because they are not required to search for work.

These two changes are welcome, but are not sufficient to compensate most...
UC recipients for the loss of the £20 a week uplift introduced at the start of the pandemic, even when combined with the higher National Living Wage (NLW). Figure 10 shows the impact of the Budget changes to UC and the higher NLW (the dark blue bars and the dark red line) and compares that to the gains that would have arisen if the Chancellor reinstated the £20 a week boost to UC (the light blue bars and the pink line). These new policies announced in the budget certainly boost incomes for people at the bottom of the income distribution (by an average of up to £450, or 2 per cent a year); however, they do not have as much of a positive effect that maintaining the £20 a week boost to UC would have done (up to £700 on average, or 5 per cent a year).

Of the 4.4 million households on Universal Credit around three-quarters (3.2 million households) will be worse off as a result of decisions to take away the £20 a week uplift and then give back via the Chancellor’s new Universal Credit measures in the Budget. Around 1.2 million households already on UC are set to net gain from these changes (with some additional households not currently on UC due to gain as the taper cut extends UC eligibility up the earnings distribution).

FIGURE 10: Budget changes increase household incomes at the bottom of the distribution, but not enough to offset the effects of the £20 a week cut to UC

Impact on annual equivalised household income of maintaining the £20 a week uplift to UC; and the reduction of the taper rate, work allowances increase and NLW increase, by income vingtile: UK, 2022-23

NOTES: The effect of the NLW rise over and above forecast earnings increases for 2022-23. The taper rate has been reduced from 63 per cent to 55 per cent. Work allowances have been increased by £42 a month. We exclude the bottom 5 per cent, due to concerns about the reliability and volatility of data for this group.

SOURCE: RF analysis of DWP, Households Below Average Income using IPPR Tax Benefit Model.
Figure 11 shows the total impact on household income of the various policies taking effect in April 2022, including those announced in the Budget and those that had been pre-announced. The overall pattern is of a progressive change, with gains at the bottom – driven by the cut to the taper in UC – and losses at the top – driven by higher National Insurance (NI) and income tax payments. In particular, these policies boost incomes in the bottom quintile of the distribution by 2.9 per cent, on average, but lead to income losses of 0.4 per cent for households in the middle quintile, and 1.5 per cent for those in the richest quintile.

Figure 12 rolls this forward to show the impact in 2025-26 of policies directly affecting household incomes announced by the current Chancellor (not including increases in the NLW). Policies announced at this Budget will continue to boost incomes at the bottom of the distribution (households in the bottom fifth of the distribution will see their incomes increase by 2.8 per cent). But the picture is worse for households on middle and higher incomes, who are affected more significantly by 2025-26 by the continued Income Tax

FIGURE 11: Policies are set to boost incomes for those at the bottom of the distribution in the coming year

Impact on household incomes of policies introduced by the Chancellor before and during this Budget, by income quintile, UK: 2022-23

NOTES: Income Tax thresholds are frozen from 2021-22 to 2025-26. Employee and self-employed National Insurance rates have increased by 1.25 per cent. The effect of the NLW rise over and above forecast earnings increases for 2022-23. The taper rate has been reduced from 63 per cent to 55 per cent. Work allowances have been increased by £42 a month. We exclude the bottom 5 per cent, due to concerns about the reliability and volatility of data for this group.

SOURCE: RF analysis of DWP, Households Below Average Income using the IPPR Tax Benefit Model; ONS, Living Costs and Food Survey; OBR, EFO October 2021.
threshold freeze, and the assumed pass-through to wages of the rise in employer NI. By 2025-26, households in the middle quintile of the income distribution are projected to see their incomes fall by 2 per cent, and households in the top quintile their incomes fall by 3.1 per cent.

FIGURE 12: The effects of the Chancellor’s policies hit higher earners further down the line

Impact on household incomes of policies introduced by the Chancellor before and during this Budget, by income vingtile, UK: 2025-26

NOTES: Income Tax thresholds are frozen from 2021-22 to 2025-26. Personal NI rise includes increase to employee and self-employed National Insurance of 1.25 per cent. The taper rate has been reduced from 63 per cent to 55 per cent. Work allowances have been increased by £42 a month. We exclude the bottom 5 per cent, due to concerns about the reliability and volatility of data for this group.

SOURCE: RF analysis of DWP, Households Below Average Income using the IPPR Tax Benefit Model; ONS, Living Costs and Food Survey; OBR, EFO October 2021.

But rising bills and the cut to UC earlier in October mean that some families on low incomes face a tough winter

The analysis above focuses on aggregate distributional analysis, but Figure 13 and Figure 14 show the living standards challenges facing specific family types over the coming months by showing how their finances will be affected by the expected changes to earnings, taxes, benefits and the cost of living between September 2021 and April 2022 (with the Annex containing four more examples).  

13 The cost to households of the increase to employer NI is smaller than that of other NI changes for three reasons: the self-employed are not affected, the assumed pass through effect to wages is only 80 per cent of the cost, and the pass-through effect to wages has dampened through consequential impacts on lower Income Tax and NI.

14 Unlike earlier Figures, Figure 13 and Figure 14 show changes to family finances in nominal terms, comparing the situation in September 2021 to April 2022. See K Handscomb, The big squeeze: Assessing the changes to family incomes over the next six months, Resolution Foundation, September 2021, for more details.
Figure 13 shows the positive effects of the changes to the UC taper rate and work allowances on incomes for a family with two adults in work (one working full-time with earnings at the 25th wage percentile and one working part-time on the NLW for 20 hours a week), who have two children. The changes to the UC taper rate and work allowances mean this family gains £42 a week, and the increase in the NLW, along with forecasted wage rises, means their incomes increase by £7 a week. For this family, policy changes more than offset the impact of the £20 a week cut to UC and high inflation.

**FIGURE 13: For families in work, the changes to the UC taper rate and work allowances are welcome improvements to their incomes**

Changes in household income per week for a couple working full-time at the 25th wage percentile and part-time (20 hours) on the NLW with two children with housing costs of £160 a week: UK, September 2021 to April 2022

NOTES: Cost of living increase calculated as effect of OBR inflation forecast on income purchasing power. Earnings increase calculated as OBR earnings forecast and National Living Wage rise.

SOURCE: RF case study model.

In contrast, Figure 14 shows how family finances will be affected over the next few months for a single adult with one child, who works part-time (20 hours a week) earning the NLW, with housing costs of £140 a week. For this family (along with the majority of families on UC), the removal of the £20 per week uplift is the largest change to incomes – a fall of £1,040 per year. The rising cost of living also has a significant effect on this family’s real income, reducing it by £6 a week. Although the likely benefit uprating in April, forecast wage rises, and changes to the UC taper rate and work allowances increase this family’s income, this is still not enough to offset the UC cut and cost of living increases over the winter.
FIGURE 14: For lower-income families, the UC cut still dominates any other income effects over the winter

Changes in household income per week for a single adult with one child, working part-time (20 hours) at the National Living Wage with housing costs of £140 a week: UK, September 2021 to April 2022

NOTES: Cost of living increase calculated as effect of OBR inflation forecast on income purchasing power. Earnings increase calculated as OBR earnings forecast and National Living Wage rise. SOURCE: RF case study model.

The Chancellor announced an additional cumulative increase in day-to-day departmental spending of £56 billion over the three years of the Spending Review

The Chancellor came into this Budget having announced a significant increase to spending on health and social care in September 2021: yesterday he confirmed that this will amount to £14 billion in total in 2022-23, falling to £13 billion by 2024-25.\(^\text{15}\)

In addition, instead of keeping to the tight spending totals that he set out less than two months ago, Rishi Sunak also took the opportunity of the improved fiscal position to go further by announcing an additional front-loaded boost to Resource Departmental Expenditure Limits (RDELs). This provides an additional £25 billion in 2022-23, declining to £19 billion in 2023-24 and £12 billion by 2024-25: cumulatively this is a £56 billion increase in forecast departmental spending. However, £5.2 billion of the extra spending in 2024-25 (over 40 per cent) is allocated to Official Development Assistance (ODA), as spending on aid is planned to return to 0.7 per cent of Gross National Income (GNI) in that year assuming the Government continues to meet the ‘fiscal tests’ it has set out for this to

\(^\text{15}\) This amount includes the additional spending allocated to departments to compensate them for the cost of the NICs increase, which was the predominant source of funding for the spending increases announced on 7 September 2021. See: HM Treasury, Chancellor launches vision for future of public spending, September 2021.
Overall, day-to-day departmental spending is set to grow by 3.3 per cent a year in real terms over the three years to 2024-25

The combination of these two decisions means that this Spending Review provides for day-to-day departmental spending to grow at an average rate of 3.3 per cent a year, in real terms. This is faster than that announced in all but one of the Spending Reviews since 2002 (see Figure 16). Over the same period, capital spending will increase at a slightly slower rate of 1.9 per cent a year on average, but this reflects the fact that the level of capital spending in the UK is already at historic highs, with the majority of the rise in capital (or investment) spending announced in this Parliament occurring between 2019-20 and 2021-22. We discuss capital spending further below.

16 For more detail see the Official Development Assistance (ODA) section of the Budget document: HM Treasury, Autumn Budget and Spending Review 2021, October 2021.
FIGURE 16: Day-to-day spending is set to rise by an average 2.3 per cent a year over the three years of the Spending Review period

Average annual change in real (GDP deflator-adjusted) day-to-day departmental spending (RDEL) and capital investment (CDEL) as detailed at each Spending Review: UK

NOTES: Nominal RDEL & CDEL are deflated using contemporaneous forecasts of the GDP deflator. SR 2020 figures are deflated using a smoothed GDP deflator to adjust for the pandemic-driven volatility in the GDP deflator.
SOURCE: RF analysis of HM Treasury, various spending review documents

Planned levels of spending are considerably higher than pre-pandemic plans in 2022-23, but are only slightly higher by the end of the Spending Review period

Figure 16 also shows that this is the third Spending Review in a row in which departments have benefitted from above-inflation increases in both day-to-day and investment (Capital Departmental Expenditure Limits, CDEL) spending. In growth terms at least, then, austerity is clearly over – and has been so since 2018-19. Between 2009-10 and 2018-19, day-to-day spending fell by an average of -0.9 per cent a year; the forecasts published yesterday suggest that the average annual real growth rate for day-to-day spending between 2018-19 and 2024-25 will be 2.8 per cent.

The sharp change in spending growth can be seen in Figure 17, which shows cash day-to-day departmental spending totals from 2009-10 to the end of the Spending Review period (we present cash figures here so as to remove the volatility caused by the GDP deflator during the pandemic). Spending totals are considerably higher than previous plans in
2020-21 and 2021-22, chiefly reflecting the impact of the pandemic on public spending.\(^{17}\) By 2024-25, plans announced at Spending Review 2021 will leave day-to-day spending at £417 billion, significantly higher than the trajectory implied by the March 2019 plans (set out by Philip Hammond), but only £7 billion higher than the plans set out by the Chancellor pre-pandemic.\(^{18}\)

**FIGURE 17:** Day-to-day spending is projected to be higher than planned in March 2019, but lower than planned in March 2020

Resource Departmental Expenditure Limits, as forecast in March 2019, March 2020, March 2021 and October 2021: UK

Despite increases over the next three years, some departments’ day-to-day budgets are still set to be significantly below 2009-10 levels by 2024-25

The Spending Review announced that almost all departments will experience real growth in spend across the Spending Review period. Assuming that Overseas Development Assistance (ODA) is indeed returned to 0.7 per cent of GNI in 2024-25, then the Foreign, Commonwealth and Development Office will receive the largest increase in its budget.

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\(^{17}\) During the height of the pandemic, the Government set aside a specific “Covid-19 reserve” to fund pandemic related expenditures. This has not been continued into the Spending Review period: instead, some departments have been allocated specific amounts for various pandemic related costs. The Budget document specifically mentions: £9.6 billion for the health service to spend on vaccines, testing and related pandemic costs; £8 billion for the NHS to deal with backlogs; £1.8 billion of school catch-up funding and £1 billion for the Ministry of Justice to tackle pressures in the court system.

\(^{18}\) These figures are taken from the OBR’s historically consistent Public Sector Current Expenditure (PSCE) in RDEL time series, which is not the same as the total published by HM Treasury.
across the spending review period, at 50 per cent.\textsuperscript{19} As shown by the pink bars in Figure 18, increases in spending are seen across most departments.

**FIGURE 18:** Many departments face day-to-day spending budgets which are smaller in real-terms than they were in 2009-10

Percentage change in real (GDP-deflator adjusted) RDEL spending, by department: UK

<table>
<thead>
<tr>
<th>Department</th>
<th>2009-10 to 2024-25</th>
<th>2021-22 to 2024-25</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health and Social Care</td>
<td>+41%</td>
<td>+3%</td>
</tr>
<tr>
<td>Home Office</td>
<td>+20%</td>
<td></td>
</tr>
<tr>
<td>Foreign, Commonwealth and Development Office</td>
<td>-19%</td>
<td>-15%</td>
</tr>
<tr>
<td>Education</td>
<td>-6%</td>
<td></td>
</tr>
<tr>
<td>Defence &amp; Single Intelligence Account</td>
<td></td>
<td></td>
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<tr>
<td>Justice</td>
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<tr>
<td>Digital, Culture, Media and Sport</td>
<td></td>
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<tr>
<td>Environment, Food and Rural Affairs</td>
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<tr>
<td>Business, Energy and Industrial Strategy</td>
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<tr>
<td>Transport</td>
<td></td>
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<tr>
<td>Work and Pensions</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**NOTES:** Comparison of departmental spending levels shown adjust as far as is possible for machinery of government and other relating spending changes. Environment, Food and Rural Affairs is also adjusted for direct payments to previously provided the EU.

**SOURCE:** RF analysis of HMT, Public Expenditure Statistical Analyses (PESA) Tables, various.

Despite this, while the Chancellor has clearly broken with the austerity of the 2010s, its legacy will live on, with the budgets for many departments remaining smaller than they were in 2009-10. Day-to-day spending at the Department of Transport, for example, will be 32 per cent lower in real terms in 2024-25 than in it was in 2009-10, and the budget of the Ministry of Justice will be 15 per cent lower. By contrast, the Health and Social Care budget is set to be over 40 per cent higher in real terms by 2024-25 than in 2009-10.

Some of this increased spending in many departments will be needed to cover public sector pay awards. Perhaps in the light of the rising cost of living discussed earlier, the Chancellor brought an end to the partial freeze to public sector pay that was in effect during 2021-22: see Box 3.

\textsuperscript{19} Assuming that FCDO receives 75 per cent of ODA spending, which is in-line with recent ODA spending outturns.
Yesterday, the Chancellor ended the one-year public sector pay freeze (affecting those earning £24,000 a year or more), which was announced in November 2020 and implemented from April 2021. The freeze was put into place after public and private sector wage growth diverged in the wake of the first Covid-19 lockdown. Between 2019-20 and 2020-21 as a whole, average regular weekly earnings grew by just 1.3 per cent, compared to growth in public sector earnings of 3.6 per cent (see Figure 19). Since large sectors of the UK economy began to reopen, however, public and private sector pay growth patterns reversed course: average private sector earnings increased by 2.4 per cent in real terms in the year to August 2021, while average public sector earnings turned negative (-0.3 per cent) over the same period.

NOTE: Figures for All public sector and All private sector are seasonally adjusted; figures for sub-sectors within the public sector are not.

SOURCE: RF analysis of ONS, Average Weekly Earnings.

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20 For further discussion of public sector pay changes, including pay variation between different public sector roles, see: H Slaughter, Earnings Outlook Q4 2020: Public sector pay, Resolution Foundation, December 2020.

21 Analysis from the HM Treasury found a similar pattern but unlike to our analysis (which focused on regular pay in real terms), focused on total pay in nominal terms. Using this approach, average private sector pay growth between 2019-20 and 2020-21 was 1.8 per cent and average public sector pay growth was 4.5 per cent.
Average pay in the public sector has long been higher than in the private sector. However, this pay gap is largely explained by differences between the public and private sector workforces, such as the type of jobs they do, education level, age. For example, having taken these factors into account, the ONS estimate that the public sector ‘pay premium’ had declined between 2011 and 2019. The IFS estimated that, in 2019, the public sector pay premium fell to zero once factors like education and age were accounted for, and previous Resolution Foundation analysis found that, after controlling for characteristics like age, education and experience, the average public sector worker affected by the pay freeze (who would have been earning £24,000 a year or more) faced a pay penalty of close to 8 per cent. (None of these analyses took account of the more generous non-wage benefits in the public sector, particularly on pensions).

Ending the pay freeze was almost inevitable given the rising levels of inflation, and the retention and recruitment problems facing some public services in the tight labour market. Furthermore, public sector wages had only begun to get back to pre-financial crisis levels (in real terms) just before the onset of the pandemic. Importantly, though, the end of the pay freeze will not automatically result in pay rises across the public sector. (It would cost at least £6 billion to raise all public sector workers’ wages by the same amount as inflation next year.) Pay rises will be contingent on departmental budgets and, in many cases, determined by the recommendations of independent pay review bodies. Indeed, the Spending Review document states that public sector pay rises will occur “over the next three years” and that public sector pay growth over that period “should retain broad parity with the private sector and continue to be affordable.”

25 Every 1 per cent increase in total public sector current expenditure on public sector pay from 2020-21 equates to £2.2 billion; with the Bank of England forecasting inflation to be 4 per cent in Q1 2022, rising all pay public sector pay by inflation could cost £8.8 billion. (This definition of pay includes wages and salaries, employers’ social contributions, payments of accruing superannuation liability charges for UK staff and locally engaged staff overseas, and amounts that finance employee contributions to pension schemes.) By limiting our focus to central government expenditure on public sector pay (which excludes those in local government, schools, hospitals, prisons, etc) we find that raising public sector pay by 1 per cent would cost £1.6 billion; raising it line with the Bank of England’s inflation forecast would cost £6.4 billion. In practice, both approaches do not perfectly capture the number of workers whose pay is under the Chancellor’s purview, for example because of how different services are devolved. An alternative approach to estimating the cost of raising public sector pay, which excludes the employer-related costs implied in our first two estimates) relies on the ONS Labour Force Survey for average annual public sector pay in Q1 2021 and multiplies that by the public sector headcount in June 2021. For all public sector workers this would equate to £1.7 billion for everyone one per cent increase in pay (and £6.9 billion to raise pay in line with 4 per cent inflation). For only those in England and Wales, this would equate to £1.5 billion for every one per cent rise, and £5.9 billion to raise pay in line with 4 per cent inflation.
But health spending has continued to be prioritised

It is worth pausing on the dominance of health spending within this Spending Review, and across recent decades more generally. Under the plans announced by the Chancellor yesterday, spending on health and social care will amount to £177 billion in 2024-25 (see Figure 20): this represents 46 per cent of the £388 billion of total RDEL allocated by Whitehall, up from the 45 per cent anticipated in 2021-22. This level of spending is also greater than envisaged less than two months ago, at the time of the announcement of the Health and Social Care Levy in September, by a cumulative £6.6 billion over the spending review period, with half of this coming in 2022-23. Over a longer time period, a staggering £84 billion of the £111 billion a year increase in Whitehall-controlled day-to-day departmental spending between 2009-10 and 2024-25 will have gone to the Department of Health and Social Care. All other departments together have seen net rises of just £27 billion.

FIGURE 20: Department of Health and Social Care spending will reach 46 per cent of total day-to-day spending controlled by Westminster

Nominal day-to-day spending on the Department of Health and Social Care and as a proportion of total day-to-day spending (excluding devolved administration block grants): UK


In part, this is driven by an increase in the modelled tax take from the Health and Social Care Levy which HM Treasury have chosen to pass on to the Department for Health and Social care in the form of higher spending.

We consider RDEL excluding block grants in this section as health and social care is a devolved policy area and this denominator therefore better conveys the proportion of spending the Chancellor is able to allocate that is directed to health care. This contrasts with the figure reported by in the IFS Green Budget 2021 which finds health and social care spend will comprise 44 per cent of day-to-day spend in 2024-25. This uses PSCE in RDEL as a measure of total spend - a historically consistent time series produced by the OBR which excludes the block grant to the Scottish government only.
The bulk of increased spending will come in the near term, undoing one third of the cuts to unprotected departmental spending since 2009-10

The result of this continued prioritisation of health and social care spending, as well as an large increase in education spending, is that the budgets of protected departments are set to grow healthily over the next few years. In 2024-25, these budgets will be almost 7 per cent larger in real per-capita terms than they were in 2009-10. But the bulk of this increase comes at the start of the Spending Review period, and unprotected departments also see much stronger spending growth in the near term. However, this picture becomes more mixed towards the end of the period.

In the final year of the Spending Review period, the health budget is forecast to grow more modestly, leaving more funds available within the envelope set out by the Chancellor for other departments. More specifically, RDEL is set to increase by £11.2 billion between 2023-24 and 2024-25, with DHSC spending growing by £4 billion and ODA spending increasing by £5.2 billion, which leaves £2 billion for other areas. In real per-capita terms, however, these plans will leave day-to-day spending for unprotected departments falling (albeit from a higher base) in 2024-25. Overall, as seen in Figure 21, spending in these areas will remain 20 per cent lower on a per-capita basis in 2024-25 than in 2009-10, with roughly one-third of the cuts that took place up to 2018-19 undone.

These projections are also reliant on an NHS spending increase in 2024-25 which, if it transpires, would be the lowest annual increase in real terms since 2012-13. Given both the ongoing pressures the health service is facing from demographic change and growing demand for procedures, as well as the risk of longer-term stresses resulting from Covid-19 and the disruption of many clinical services, it seems reasonable to be sceptical of whether such a spending plan will go ahead.

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29 Here protected departments are defined as: Department of Health and Social Care, Department for Education, Ministry of Defence & the Foreign, Commonwealth and Development Office (FCDO). The increase in ODA by £5.2 billion in 2024-25 has not yet been allocated to departments by HM Treasury. For illustrative purposes, and in line with ODA spending outturns, in this analysis we allocate three quarters of it to the FCDO.
The business and transport departments are the big winners in the shift towards higher investment in capital spending

Capital spending remains a key part of the Government’s overall strategy. Here, the big picture has changed little over the course of the pandemic. Following the 2019 General Election, capital spending plans were increased substantially so that they amount to around 3 per cent of GDP - a rise of 50 per cent in real terms by the end of the forecast compared to 2019-20. Subsequent fiscal events have maintained roughly the same spending envelope, with details of specific spending plans gradually become clearer. As shown in Figure 22, this means that public sector net investment is set to rise to its highest sustained level since the late 1970s. And if the Chancellor is able to spend all the allocated capital budget, this will be the first recession since the 1960s in which investment has not fallen relative to its pre-recession level at some point in the five years following.
FIGURE 22: Public sector is set to remain at levels not sustained since the late 1970s

This prioritisation of investment spending means that overall capital spending looks quite different to day-to-day spending. As shown in Figure 23, real-terms capital department expenditure limits (CDEL) is set to surpass pre-austerity levels of spending this year both in aggregate and per-capita terms.

As part of the Spending Review, capital budgets for the next three years have now been fully allocated. Figure 24 compares the shape of capital spending across departments between 2024-25, the final year of the Spending Review, and 2010-11, the pre-austerity peak in investment. When viewed by department, the new plans represent a significant shift in capital spending towards the Department for Business, Energy and Industrial Strategy (BEIS) and the Department for Transport (DfT). These two departments are expected to account for nearly two-in-every-five (37 per cent) pounds spent on investment, compared with slightly more than one-in-five (23 per cent) in 2010-11. Higher transport spending has been a high-profile part of the Government’s ‘levelling up’ agenda, while BEIS capital spending reflects measures designed to raise science spending and deliver on net zero commitments. In contrast education has seen its share of capital spending fall by almost two-thirds over this period.
FIGURE 23: Capital spending is set to rise above pre-austerity levels this year
Indices of real-terms (GDP-deflator adjusted) capital departmental expenditure limits, 2009-10 = 100: UK

SOURCE: OBR, Economic and Fiscal Outlook, March 2021.

FIGURE 24: Investment spending priorities have shifted markedly since 2010
Share of departments in total capital spending (capital DEL): UK, 2010-11 and 2024-25

NOTES: Local government is CLG in 2010 and is DLUHC and levelling up fund in 2024-25. Business, energy and climate change includes Department of Energy and Climate Change plus Department for Business Innovation & Skills in 2010-11, and the Department of Business, Energy & Industrial Strategy in 2024-25, not adjusting for machinery of government changes e.g. the transfer of Higher Education spending to the Department for Education.

The Budget did not signal a laser like focus on meeting net zero targets

The main new environmental measure flagged in the Budget was a reform of air passenger duty (APD), which will introduce an additional long-distance band for those flying further than 5,500 miles. However, this was accompanied by a halving of domestic APD rates, highlighting the broader challenge of ensuring aviation tax policy is consistent with the need to curb growth in demand. The Budget yet again froze fuel duty, at a cost of around £1.5 billion a year; as the OBR note, the cumulative cost of freezing fuel duty rates between 2010-11 and 2020-21 relative to increasing them in line with RPI inflation is around £65 billion.

Additionally, the Budget detailed £21 billion of spending on decarbonising buildings, transport, industry, and energy, and providing support for innovation through to 2024-25 (see Figure 25). Of this, £5.5 billion was new capital announced last week to cover the commitments made in the Net Zero Strategy and Heat and Buildings Strategy, and £1.7 billion is additional support to incentivise investment in a new nuclear power station. However, this level of spending is unlikely to be commensurate with what required by the Government’s own route to net zero plans. This decarbonisation pathway requires £5-6 billion of new capital investment for each remaining year of the third carbon budget (2021-22), and then £32-33 billion over each year of the fourth carbon budget (2023-37).

In particular, major gaps remain on decarbonising residential buildings with the Government off-course from delivering its manifesto pledge to spend £6.3 billion on efficiency and clean heat for domestic property by 2030. At the same time, measures to deliver building upgrades via private investment remain limited.

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30 The Exchequer impact of changes to APD total a cost of £130 million from 2023-24 to 2026-27 as the £140 million raised by through a new long-haul band is more than offset by a £275 million cost of reducing domestic APD. Increasing long-haul APD is expected to lead to a demand reduction of less than 1 per cent, while cutting domestic APD is expected to increase demand by 3.5 per cent.
31 The CCC’s Balanced Net Zero Pathway assumes a passenger demand growth of 18 per cent on 2018 levels by 2050. In 2018 emissions from UK aviation were 88 per cent above 1990 levels.
32 OBR, Economic and Fiscal Outlook, October 2021.
33 This figure does not include an annual spend of around £1 billion to cover legacy payments under the Renewable Heat Incentive, a scheme introduced in 2011.
35 Not all of these costs will be funded by the state. In its Fiscal Risks report, the OBR’s central scenario assumes public investment will meet 27 per cent of total investment costs.
36 The Heat and Buildings Strategy pledged £950 million for Home Upgrades Grants, £800 million for decarbonising social housing, £450 million in grant support for heat pumps and £338 million for heat networks.
FIGURE 25: Net zero spending is set to increase, but falls short of that needed
Total pledged net zero spending over the current Parliament: UK

NOTES: Spending on the Renewable Heat Incentive, a legacy scheme dating from 2011, is not included. £5.5 billion of new investment was delivered across the Net Zero Strategy and Heat and Buildings Strategy, with an additional pledge of up to £1.7 billion for new nuclear power in the Budget. All other investment is pre-announced.
SOURCE: RF Analysis of 2021 Autumn Budget.

In addition to new funding, the Chancellor gave a long-overdue green light to the Regulated Asset Base (RAB) funding model for new nuclear power stations, likely paving the way for a Final Investment Decision to be made on EDF’s Sizewell C project by the end of this Parliament. This model, however, transfers significant construction risk onto households via energy bills. Using bills to de-risk infrastructure investment, as opposed to support via general taxation, is attractive to the Treasury as it avoids further pressures on public spending, but is also regressive and can run contrary to the Government’s own ambition of reforming levies to hasten the uptake of low carbon heat.

37 Under the RAB model, households and businesses will face a levy on energy bills before new plant begin generating, thereby increasing exposure to cost overruns and delays. This is concerning, as a 2014 survey of 180 nuclear projects found that 97 per cent came in over budget, with an average cost escalation of 117 per cent. See: B Sovacool et al., Risk, innovation, electricity infrastructure and construction cost overruns: Testing six hypotheses, September 2014. Projects using the same European Pressurised Reactor design as that proposed for Sizewell C at Flamanville in France and Olkiluoto in Finland are both running over budget and behind schedule.
The fiscal outlook has improved but, with heightened economic uncertainty, the Chancellor’s plans could be blown off course

The stronger economy has improved the fiscal outlook

The faster-than-expected recovery in economic activity has materially improved the short-term fiscal position, with the OBR forecasting that public sector net borrowing (PSNB) will be £51 billion lower in 2021-22. This represents 2.1 per cent of GDP and is the largest fall in borrowing in the first year of the fiscal forecast on record. Figure 26 shows the summary forecasts for borrowing and debt. PSNB is forecast to be materially lower every year, compared to the OBR’s March 2021 forecast, and actually falls below the OBR’s pre-pandemic forecast from March 2020: PSNB is expected to be 1.7 per cent of GDP in 2024-25, compared to 2.2 per cent for the same year in the March 2020 forecast. The significantly lower borrowing throughout the forecast period means the public sector net debt (PSND) forecast has also been revised down, peaking at 97.9 per cent of GDP. But, although borrowing eventually falls back below pre-pandemic levels, one legacy of the pandemic is an upwards step-change in the level of PSND.

![Graph showing borrowing and debt forecasts](image-url)

**Figure 26: Borrowing is set to fall faster than expected and debt to peak lower**

Public sector net borrowing and public sector net debt, outturn and forecasts: UK

**Notes:** Figures are shown in 2020-21 prices, using contemporaneous GDP deflator outturns and forecasts; revisions to national accounts data has affected the profile of borrowing and debt in addition to changes in nominal values.


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38 Consistent forecasts are available back to 1980 – changes in the first year of successive forecasts are calculated using the forecast for PSNB for the fiscal year in which the forecast is made relative to the most recent forecast for the same year. So, in this case we have compared the forecast for 2021-22 PSNB made for the Autumn Budget 2021 to the Spring Budget 2021’s forecast for PSNB in 2021-22.
The OBR continues to forecast a rapid improvement in the borrowing figures, partially reflecting its estimate of relatively little medium-term economic ‘scarring’ from the pandemic. And the new fiscal forecasts show lasting reductions in borrowing thanks to higher growth and inflation. A significant proportion of the underlying improvement in the fiscal forecasts has been utilised by the Chancellor to loosen fiscal policy, as shown in Figure 27. The cumulative forecast for PSNB was £141 billion lower, between 2022-23 and 2025-26, as a result of the improved economy, prior to the effect of changes in policy made since March 2021. Total policy measures taken since March 2021 are projected to cumulatively raise borrowing between 2022-23 and 2025-26 by £64 billion, suggesting about half of the ‘windfall’ from a stronger economy has been used by the Chancellor to loosen fiscal policy. But, as Figure 27 makes clear, this loosening is relatively frontloaded – i.e. policy is loosening by more in the next two years than by the end of the forecast. This is driven partially by increasing revenue from higher taxes over time, as well as the profile of additional spending (where increases have been larger in the near-term than the medium-term).39

FIGURE 27: The windfall from a stronger economy has been partially used to loosen fiscal policy

Changes to OBR’s public sector net borrowing forecast: UK, March to October 2021

NOTES: Indirect spending and receipts changes reflect the second-order effects of fiscal policy on the economy. Figures are in nominal terms.
SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, October 2021.

Stepping back, the latest OBR forecast is that borrowing will fall over the next five years at the third fastest rate on record – 6.3 per cent compared to the 6.7 per cent fall after the

39 It is worth highlighting that the loosening in fiscal policy is estimated to improve the economy leading to a second-round (or indirect) effect on the fiscal forecast: for example, in 2023-24, PSNB is expected to be £7 billion lower as a result of the policy measures taken since March boosting the economy.

Resolution Foundation
early 1990s recession (Figure 28). This rapid fall reflects a number of interrelated factors. First, fiscal policy was more active during the pandemic than in previous recessions because the highly variable economic effects across households and firms required targeted macroeconomic support. Second, some of the fiscal support measures during the financial crisis did not raise borrowing, so it had less far to fall after the recession.\(^ {40} \) And third, the economic contraction caused by Covid-19 was the largest in at least 100 years, matched also by a notably fast recovery, naturally leading to similarly large swings in borrowing. But, crucially, the rapid fall in borrowing is partially driven by tightening policy, such as the cut to Universal Credit, rising corporation tax and the increase in National Insurance – all of which were announced prior to this Budget.

Despite relatively minor giveaways, taxes are set to rise quickly to levels not seen since around 1950

Recent Budgets and fiscal announcements have introduced substantial new tax rises, notably the increase in the Corporation Tax rate to 25 per cent from April 2023

\(^ {40} \) For example, some of the bank bailout schemes.

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announced in the Spring 2021 Budget, and the increase in National Insurance from April 2022, announced in September 2021. This Budget did not include major new tax increases. But it did contain a number of more minor tax reductions. Consumers benefited from the annual tradition of freezing fuel duty, set to cost the Government more than £1.5 billion a year, and a general reduction in alcohol duties (costing around £800 million a year by 2026-27). For businesses, there were more material, but targeted, announcements. Business rates relief of 50 per cent for the retail, hospitality and leisure sectors, extending the £1 million investment allowance and freezing the business rates multiplier, will together cost around £3 billion in 2022-23. And over the longer-term, tweaks to the bank surcharge tax will cost the Chancellor £1 billion per year by 2026-27.

And the trend for recent Budgets to raise additional tax means that taxes are now on track to reach the highest share of the economy since around 1950 (Figure 29) (taking the broader measure of public sector receipts, the trend is slightly less stark with the Government’s plans set to reach levels last seen in 1982-83). A tax take of 36.2 per cent of GDP by 2026-27 would amount to an increase per household since Boris Johnson became Prime Minister of around £3,000 (measured in 2020-21 prices). The pace of the increase in taxes next year is particularly fast – taxes, as a share of GDP, are expected to rise by 1.6 percentage in 2022-23. This is the largest one-year increase since 1997-98, and the fastest rise following a recession since 1981-82.

### FIGURE 29: Tax is set to reach the highest share of GDP since around 1950

Total managed expenditure, tax and government receipts as a proportion of GDP: UK

Dotted lines represent estimates using historic data from the Bank of England

NOTES: Data prior to 1955 are for calendar years, rather than fiscal years.
Rising taxes, of course, are happening because the government wants to combine fiscal conservatism with higher spending in an era of low growth. Public sector total managed expenditure (TME) is expected to hit the highest share of the economy, outside of recessions, since the early 1980s: this trend reflects the growing pressure on the state as a result of demographic and other underlying pressures, particularly the rising cost of healthcare.

The combination of an improving economy and a tightening of fiscal policy as the years go by means the Government is on track to meet its new fiscal rules.

At the start of the pandemic, the Government chose not to adopt the fiscal rules proposed in the 2019 Conservative manifesto: this was very sensible, given that the fiscal rules in place at the time were not designed to operate during a recession.

At this Budget, the Chancellor announced the introduction of a new fiscal framework. This included a primary rule to have ‘underlying’ debt on a falling path in the third year of the fiscal forecast (so 2024-25 at this Budget).\(^41\) In addition, the framework included three supplementary rules: a rule not to borrow for day-to-day spending in the third year of the forecast (i.e. achieve a positive current balance); a limit on public sector net investment of 3 per cent of GDP over a rolling five-year period; and a cap on the total spending on welfare. These are broadly in line with the fiscal rules that the Labour Party has proposed, albeit with less clarity on the time period over which the opposition believes they should be met. In practice, the debt falling and current balance rules are the clearest constraint on fiscal policy, so we focus on these below.\(^42\)

Figure 30 compares the current forecast headroom against these rules (i.e. the difference between the OBR’s forecasts for the current balance and debt, and the minimum required to meet the rules) to previous rule regimes. It is clear that the headroom is relatively low, despite the majority of the large economic windfall being used to improve the fiscal forecasts by the middle of this decade (furthermore, none of the fiscal rule regimes shown in the left-hand chart was actually achieved at the point at which they were supposed to apply – this reflects the challenge with a rolling target, where the Government merely needs to set plans to meet the rules, rather than ever meet them in actuality).

\(^{41}\) The measure of debt used for the fiscal rules excludes the impact of the Bank of England, where support schemes, such as the Term Funding Scheme, have temporarily raised the measure of public sector net debt.

\(^{42}\) The new fiscal framework also includes a new focus on various broader measures of the Government’s balance sheet. This is welcome, as the narrow focus on debt can provide a misleading picture of fiscal sustainability. However, it remains to be seen how the new approach will function in practice.
Fiscal rules need to be designed to match the current economic environment – and the overriding feature of the economic outlook is one of uncertainty. Significant risks to the economic recovery remain: the pandemic is not yet over, inflation is rising quickly and GDP growth has slowed. The average forecast error for the current balance after three years is over 2 per cent of GDP – more than three times the headroom the Chancellor currently expects against his fiscal rules. This suggests that even small downside news to the economic forecast would wipe out the fiscal headroom, potentially leading to a tightening in fiscal policy.

There is a broader question around whether these are the appropriate set of fiscal rules. Previous Resolution Foundation analysis has highlighted the importance of a cyclically-adjusted rule which allows for greater flexibility for fiscal policy. Under such a rule, were the economic outlook to deteriorate, fiscal policy could provide more stimulus; were the economy to strengthen, it would require tighter policy. It is also vitally important that rules enable fiscal policy to support the economy through more severe economic downturns. The best way to achieve this is through a ‘knock-out’ clause where the rules are suspended or revised should the economy deteriorate past a set threshold. The

NOTES: Figures in brackets show headroom as a proportion of contemporaneous GDP. Historic headroom figures are measured at their announcement.

SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, October 2021; OBR, Fiscal Risks Report, July 2019; OBR, Historical Forecasts Database.
Chancellor’s new rules do not have this feature, and so are at risk of once again being ditched should the economy worsen.45

Fiscal policy has moved to be more supportive of the recovery

Fiscal policy has been the primary tool of macroeconomic stabilisation during the pandemic, not least because monetary policy is constrained by already-low interest rates. Figure 31 presents our estimate of the impact of macroeconomic policy on quarterly GDP growth, showing that around two-thirds of the total support during the pandemic came from fiscal policy. But it is clear that fiscal policy is now moving from a period of substantial economic support to becoming a drag on growth as support measures are withdrawn, including the end to the Universal Credit uplift, as well as the various increases to taxes discussed above.46 This Budget has somewhat changed the approach of fiscal policy, moving in the direction of looser policy and more stimulus to the economy over the next year.

This is broadly the right approach given an important lesson from the past decade has been that, as central banks around the world are constrained by the lower bound on interest rates, fiscal policy must play a bigger role in stabilising the economy. But this more active stabilisation role inevitably leads to increases in borrowing and debt levels. To prevent a ratchet up in the level of debt after every recession, fiscal policy should be tightening faster during boom periods. Fiscal policy should aim to provide aggressive support during recessions and recoveries, but reverse stance once the economy is back on track.47

45 For more discussion of the appropriate set of fiscal rules for the current economic environment see, J Leslie et al, The Uncertainty Principle: Previewing the decisions to be taken at the Autumn Budget and Spending Review 2021, Resolution Foundation, October 2021

46 It is also turning negative because the impact of fiscal support on the level of GDP is estimated to wane over time, meaning that previous support measures are starting to become a negative contributor to quarterly GDP growth rates.

47 For more analysis on the stance of fiscal policy over the economic cycle see G Bangham et al, Unhealthy finances: How to support the economy today and repair the public finances tomorrow, Resolution Foundation, November 2020.
FIGURE 31: Fiscal policy support for the economy has largely ended

Estimated impact of monetary and fiscal policy 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.

Conclusion

The Chancellor yesterday got his first chance to set out what the UK’s post-pandemic economy might look like by the mid-2020s. What we have learned is that it is not the high-wage economy envisaged by the Prime Minister last month, or even the lower-tax economy that Rishi Sunak said was his goal yesterday. Instead the Chancellor has set out plans for a new high-tax, big-state economy. Higher taxes are not a surprise given the UK is combining fiscal conservatism with an ageing society and slow-growing economy. But the Budget clearly marks the end of low tax conservatism, with the tax take rising by £3,000 per household by the middle of this decade.

However, although tax revenues and NHS spending will be growing rapidly in this economy, growth in pay packets and family incomes looks far more anaemic – a huge challenge that the welcome rise in the National Living Wage and boost to Universal Credit eased but did not overcome. With Britain still getting to grips with the impact of...
Covid-19, Brexit and the Net Zero transition over the coming decade, the country remains in need of an economic strategy that steers us through this period of huge economic change while addressing long standing challenges of low productivity and high inequality.
Annex: Family case studies

This annex features some additional case studies on how changes to government policy, earnings and forecasts affect household incomes for a range of families.

**FIGURE 1: Wage rises do much to help those on the NLW with the cost of living**

Changes in household income per week for a single adult, working full-time at the National Living Wage: UK, September 2021 to April 2022

- Current September income
- £20 UC reduction from October
- Cost of living increases from September to April
- Likely benefit uprating in April
- Change to National Insurance thresholds
- Forecast wage rises
- Change to UC taper rate and work allowances
- Higher employee National Insurance rates
- Higher Council Tax
- April income

NOTES: Cost of living increase calculated as effect of OBR inflation forecast on income purchasing power. Earnings increase calculated as OBR earnings forecast and National Living Wage rise. SOURCE: RF case study model.
FIGURE 2: Benefit uprating and changes to UC help families with children in work

Changes in household income per week for a single-earning couple with two children, working full-time at the National Living Wage with housing costs of £160 a week: UK, September 2021 to April 2022

Notes: Cost of living increase calculated as effect of OBR inflation forecast on income purchasing power. Earnings increase calculated as OBR earnings forecast and National Living Wage rise. Source: RF case study model.

FIGURE 3: Higher taxes and the rising cost of living mean incomes fall for workers on the median wage

Changes in household income per week for a single adult, working full-time at the median wage: UK, September 2021 to April 2022

Notes: Cost of living increase calculated as effect of OBR inflation forecast on income purchasing power. Earnings increase calculated as OBR earnings forecast and National Living Wage rise. Source: RF case study model.
FIGURE 4: Changes to UC in the Budget do nothing to help people who are not working

Changes in household income per week for a single unemployed adult: UK, September 2021 to April 2022

NOTES: Cost of living increase calculated as effect of OBR inflation forecast on income purchasing power. Earnings increase calculated as OBR earnings forecast and National Living Wage rise. SOURCE: RF case study model.
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