Resolution Foundation
BRIEFING

Inflation Nation

Putting Spring Statement 2022 in context

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Summary

It's hard to overstate the scale of the cost of living crisis that's coming in 2022-23, with the highest inflation in 40 years and the worst income squeeze on record lying ahead of us. Against that backdrop, and with fiscal ammunition thanks to the Office for Budget Responsibility's (OBR's) borrowing forecasts improving by £42.4 billion over five years, the Chancellor set himself two tasks at Spring Statement 2022: to offer the public some protection against the surging cost of living, and to show the Conservative Party that he is a tax cutter. He set out significant packages on both fronts. But an indefensible refusal to target support at low- and middle-income households next year, and previously announced tax rises, meant he has fallen well short of both goals.

The stronger than expected recovery from the pandemic is about to be undermined by surging inflation

The British economy has continued its stronger-than-expected recovery from the pandemic, with the economy now around 0.5 per cent larger, and unemployment almost 400,000 lower, than projected in October 2021. But surging inflation is the main economic news, with the OBR doubling its forecast for 2022's inflation peak to 8.7 per cent. Rising costs for firms and falling incomes for consumers mean that growth for 2022 has been revised down from 6 per cent to 3.8 per cent, although (unlike the Bank of England) the OBR assume there is no lasting damage to the size of the economy.

There is, however, significant damage to real wages, which are projected to fall by 3.6 per cent over the course of 2022. The slow recovery from this fall, on the back of the disastrous wage stagnation of the past decade, means that by 2027, real wages are set to have grown by just £18 a week since the financial crisis, compared to £240 a week if they had grown in line with the pre-financial crisis trend.

Immediate support has done little for the low- and middle- income households worst affected by the rising cost of living

The Chancellor has responded to surging inflation with a significant, but poorly targeted, package of support for 2022-23, choosing to rebuild his tax-cutting credentials rather than target the households worst affected by the rising cost of living. Measures include raising the National Insurance threshold from £9,880 to £12,570 in July, a 5p cut to Fuel Duty rates, and a £500 million increase to the Household Support Fund.

Only £1 in every £3 for the measures announced yesterday will go to the bottom half of the income distribution. Households in the top half gain an average of £475, compared to just £136 for the poorest fifth of households. If we consider these measures alongside previously announced support for energy bills and (larger) tax rises, the Treasury is only offering limited support to household budgets next year: an average boost of £110. That average hides big losses amongst higher income households from tax increases: a typical household gains £323, but policy changes will actually make households in the top half of the income worse off, on average, by £169 a year.

Even taking into account the support measures announced by the Chancellor yesterday, the typical working-age household faces an income fall of 4 per cent or £1,100 in 2022-23. But the greatest falls will be felt by the poorest quarter of households who are set to see their real incomes drop by 6 per cent as benefits fail to keep pace with the rising prices. As a result, a further 1.3 million people will fall into absolute poverty next year including 500,000 children – the first time Britain has seen such a rise in poverty outside of recessions.

This scale of income shock is not one the country is projected to recovery swiftly from. Incomes are on course to be lower at the next election (2024-25) than they were at the previous (2019), with typical non-pensioner income projected to be 2 per cent lower. Such an outcome would make this the worst parliament on record for living standards growth.

Despite the headlines, taxes are going up not down

Looking further ahead, the Chancellor also announced a 1p cut in the basic rate of Income Tax for April 2024 which looks set to save the average earner £243 a year. But the gains of this and the lasting impact of a higher National Insurance threshold are more than wiped out by previously announced tax rises: the Health and Care Levy combined with the freeze to Income Tax thresholds.

In 2024-25, when the income tax cut comes into effect, 27 million out of the 31 million people in work will pay more Income Tax and NI as a result of personal tax changes announced by Rishi Sunak. Households in the middle of the income distribution will on average be £535 a year worse off, while losses among the richest ten percent will average over £2,000. Cutting the basic Income Tax rate while raising that for National Insurance (via the Health and Care Levy) also makes little sense. It widens the gaps in marginal tax rates paid by many working-age people versus those in retirement, or workers versus landlords, on the same level of income.

Looking beyond just personal income taxes, the Chancellor set out his intention to support capital and R&D investment by British firms, but the big picture is taxes going up, not down. Tax receipts as a share of the economy are set to reach their highest level since 1982-83 – the equivalent of a £3,000 rise per household since the 2019 election.

The Chancellor did not offer protection for public services from rising inflation

Although the Chancellor stepped in to offer households some protection from higher than expected inflation, he chose not to do so for public services. This in part reflects the fact that costs of production in the UK are not rising as fast as the costs of consumption, with the latter driven by the cost of imports (particularly energy). As a result, the 3.3 per cent annualised real increase in non-Covid day-to-day spending between 2021-22 and 2024-25 that was planned in Autumn 2021 has fallen, but only to 2.9 per cent. Real day-to-day spending on defence will now decline by 5.7 per cent between 2021-22 and 2024-25, up from the 4.3 per cent fall expected in October.

Unlike household finances, the public finances have improved

While household finances are taking a hammering, the public finances have actually been on the up: tax receipts have come in much stronger in 2021-22 than expected and the OBR expects a lasting improvement on that front that averages to around £35 billion a year. This is only partially offset by (the eventually) higher benefit and (largely temporary) debt interest spending as a result of higher inflation, leaving borrowing across the forecast period projected to be £25.6 billion lower than expected in the Autumn even accounting for the significant tax cuts announced yesterday.

This contributes to a staggeringly quick fiscal consolidation, with borrowing falling from 14.8 per cent in 2020-21 to just 1.3 per cent in 2024-25. That would amount to three-times the fall seen over the same length of time post-financial crisis, taking the deficit to well below where it had been expected to reach before the pandemic, and to its lowest levels since the surpluses of the early Gordon Brown chancellorship. As a result, the Chancellor's headroom against his fiscal rules (the binding rule that requires him to have debt falling in 2024-25) has increased to £28 billion from the £18 billion forecast in October 2021. That is the equivalent to a further 4p to 5p cut in the basic rate of Income Tax.

This Spring Statement saw the Chancellor prioritise rebuilding his tax-cutting credentials over supporting the low-to-middle income households who will be hardest hit from the surging cost of living, but while also leaving himself fiscal flexibility in the years ahead. The package of measures announced offered some immediate support to households and laid the ground for a 2024 election. But on both counts it looks likely to be far from the last word.

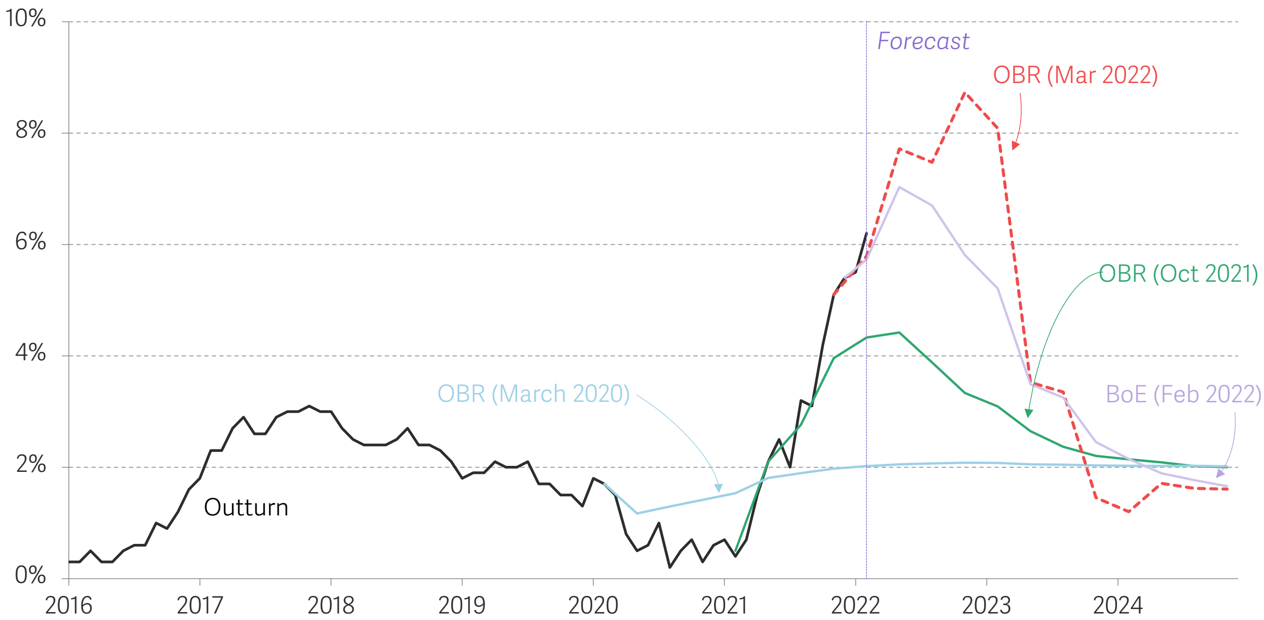
The OBR is forecasting a huge rise in inflation that will dominate the economic and fiscal outlook

The key context to the Spring Statement is a near doubling of the OBR's inflation forecast, signalling a huge hit to living standards. CPI inflation was already at a 30-year high in February, but the Russian invasion of Ukraine is set to push inflation even higher, driven by further rises in the price of energy. As a result, the OBR has nearly doubled its forecast for inflation this year from 4 per cent to 7.4 per cent. Inflation now has 'twin peaks' this year: in October, inflation was expected to peak at 4.4 per cent in Q2 2022, but the OBR's latest forecast is for inflation to rise to 7.7 per cent in Q2 2022 before rising further in the second half of the year, eventually peaking at 8.7 per cent in Q4 2022 (see Figure 1).

The OBR acknowledges that there is significant uncertainty around its inflation forecast – not least because it closed the forecast on 2 March, since when oil and gas prices have fallen. Nevertheless, it is clear that we are set for a huge rise in prices: by the time inflation returns to the Bank of England's 2 per cent target (in Q4 2025), the level of consumer prices is around 5 per cent higher than expected in October.

FIGURE 1: **The OBR is forecasting the highest inflation in its history**

Outturn and forecasts for 12-month CPI inflation: UK



SOURCE: RF analysis of ONS; OBR, Economic and Fiscal Outlook, various; Bank of England, Monetary Policy Report, February 2022.

The nature of the rise in inflation means that it be disastrous for family finances but, as we show later, contribute to stronger public finances. The combination of a faster-than-expected recovery at home and abroad, with a shift in spending away from services and towards goods, has been met by higher inflation concentrated in the price of traded goods, particularly energy.[1] This sort of shock means it costs more for the UK to buy goods from the rest of the world, effectively making us poorer, hobbling the recovery. But the faster recovery has also led to a tighter labour market, met by rate rises from the Bank of England.[2]

Given all this, we start with a brief discussion of the impact of high inflation on the economy, before discussing the policy measures taken in response.

Despite the stronger recovery so far, the jump in the cost of living means the OBR's growth outlook is weaker in the near term

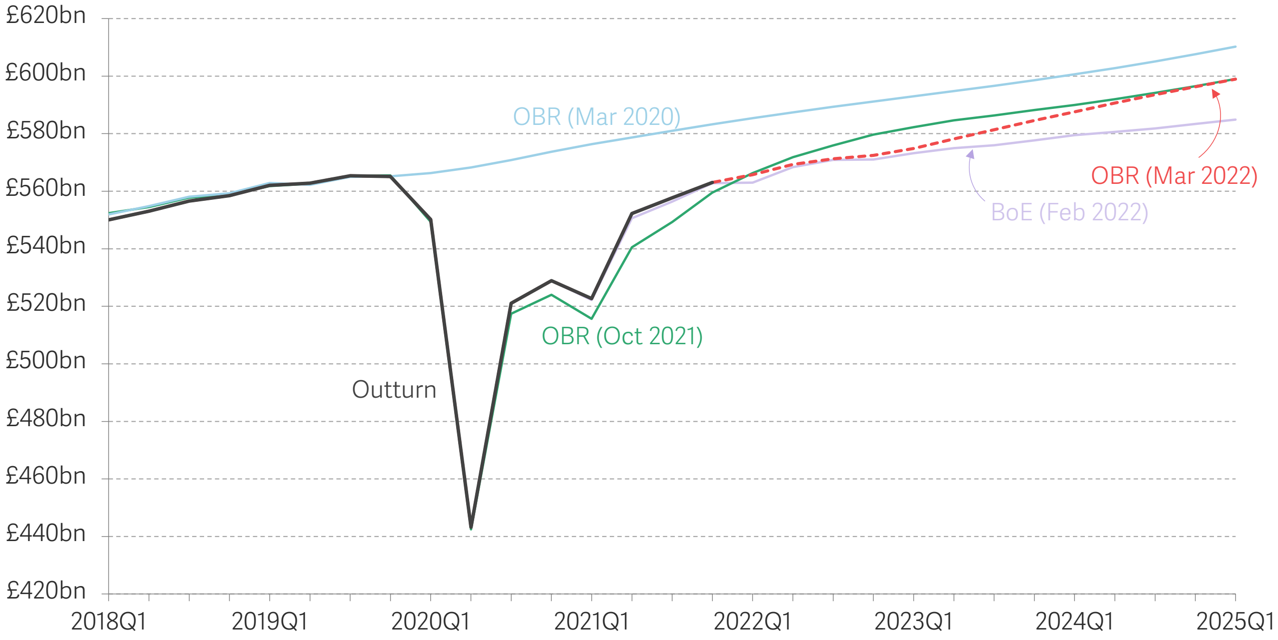
The good news for the Chancellor is that the stronger-than-expected recovery, with the fastest year of peacetime growth in nearly a century last year, has meant that the economy starts the forecast about 0.5 per cent larger than expected in October. This is despite an unforeseen 'blip' from Omicron which reduced GDP by 0.2 per cent in December.

But the outlook is weaker, with higher inflation leading to a substantial markdown in growth for this year. As shown in Figure 2, the OBR is now expecting growth this year to be 3.8 per cent, considerably weaker than the 6 per cent forecast in October. This is the largest markdown to an official fiscal forecast for calendar-year growth outside of a recession. About 0.7 percentage points of this reflects the stronger-than-expected growth in 2021, but most reflects the impact of higher inflation. Looking further ahead, growth has also been marked down in 2023 before recovering to leave the size of the economy little changed from the previous forecast in the medium term. This reflects the OBR's continued assumption of 2 per cent 'scarring' from the pandemic.

1 For more on the drivers of inflation, see: J Smith, Macroeconomic Policy Outlook: Q1 2022, Resolution Foundation, March 2022.
2 See, for example, Minutes of the Monetary Policy Committee meeting ending on 16 March 2022, Bank of England.

FIGURE 2: **The OBR's forecast for GDP starts stronger but is weaker further out**

Quarterly real GDP, outturn and select forecasts: UK



NOTES: Historic forecasts have been adjusted to reflect ONS revisions to the level of GDP.
SOURCE: RF analysis of ONS; OBR, Economic and Fiscal Outlook, various; Bank of England, Monetary Policy Report, February 2022.

While the real size economy is little changed, cumulative growth in nominal GDP over the forecast – a key driver of tax revenues – is slightly higher than it was in the OBR's October forecast. This reflects somewhat higher GDP deflator inflation, albeit to a much lesser extent than for consumer prices because of the smaller role for higher import prices.

Given the huge jump in CPI inflation forecast by the OBR, and the negative effects it will have on incomes and higher energy costs will have on production, it is perhaps surprising that there is no lasting hit to economy. The OBR does note that there is a risk that there could be more bad news stemming from the conflict in Ukraine. Nonetheless, the OBR's forecasts for GDP are noticeably stronger than those from the Bank of England (Figure 2) despite a much bigger rise in inflation (Figure 1). A key reason for this is that OBR's forecast is based on futures prices for oil and gas which imply that prices will fall back sharply from their current elevated levels (the Bank of England's forecast in contrast assumes constant wholesale energy prices beyond six months). This means that the required adjustment to higher import prices is much smaller in the OBR's forecast.
As explained below, this contributes to limiting the extent to which unemployment increases.

The resilience of the labour market has been hugely good news, but higher inflation is set to hit pay packets

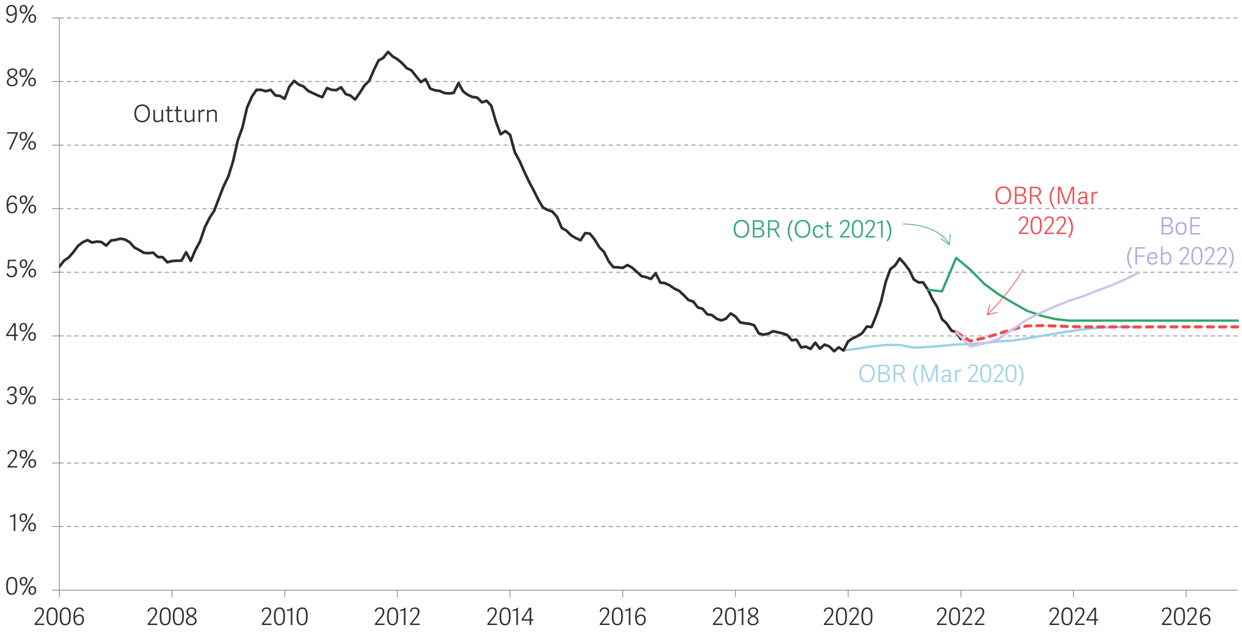
Faster-than-expected GDP growth and policy support has combined to deliver an unprecedented bounce back in the labour market. The unemployment rate fell to 3.9 per cent in the three months to February 2022, below pre-pandemic levels. As a result, the labour market is now tighter than at any point in the past 20 years.[3] This represents the fastest return to pre-crisis unemployment on record, considerably faster than after the financial crisis: the unemployment rate has fallen by 1.2 percentage points in the twelve months to January 2022, compared to an average fall of 0.5 percentage points per year between 2011 and 2019.[4] And, due to the current strength of the labour market, the OBR expects the unemployment rate to remain at 3.9 per cent in the first quarter of 2022, 1.1 percentage points lower than its forecast in October 2021. This revision equates to 388,000 fewer people being unemployed.

In the medium term, the OBR's projection is for unemployment to remain low, peaking at only 4.2 per cent in 2023 (see Figure 3). In this respect, the OBR's forecast differs considerably from the Bank of England's February forecast which embodied a pickup in unemployment to 5 per cent by 2025. The OBR's forecast is much more 'Federal-Reserve like' in its approach – predicting a sharp fall in inflation without a large rise in unemployment – dubbed an 'immaculate disinflation'.[5] However, although the OBR is optimistic about unemployment, it has revised its medium-term participation prediction downwards, reflecting higher economic inactivity among full-time students and those with long-term ill health. This fall in participation is set to outweigh the fall in unemployment, with the OBR revising medium-term total employment down by 104,000 compared to its prediction in October 2021.

3 G Thwaites, Labour market tight, household budgets tighter, Resolution Foundation, March 2022.
4 N Cominetti, L Gardiner & H Slaughter, The Full Monty: Facing up to the challenge of the coronavirus labour market crisis, Resolution Foundation, June 2020.
5 J Smialek, Fed raises rates and projects six more increases in 2022, New York Times, March 2022.

FIGURE 3: **The OBR predicts only a small rise in unemployment**

16+ unemployment rate, outturn and projections: UK



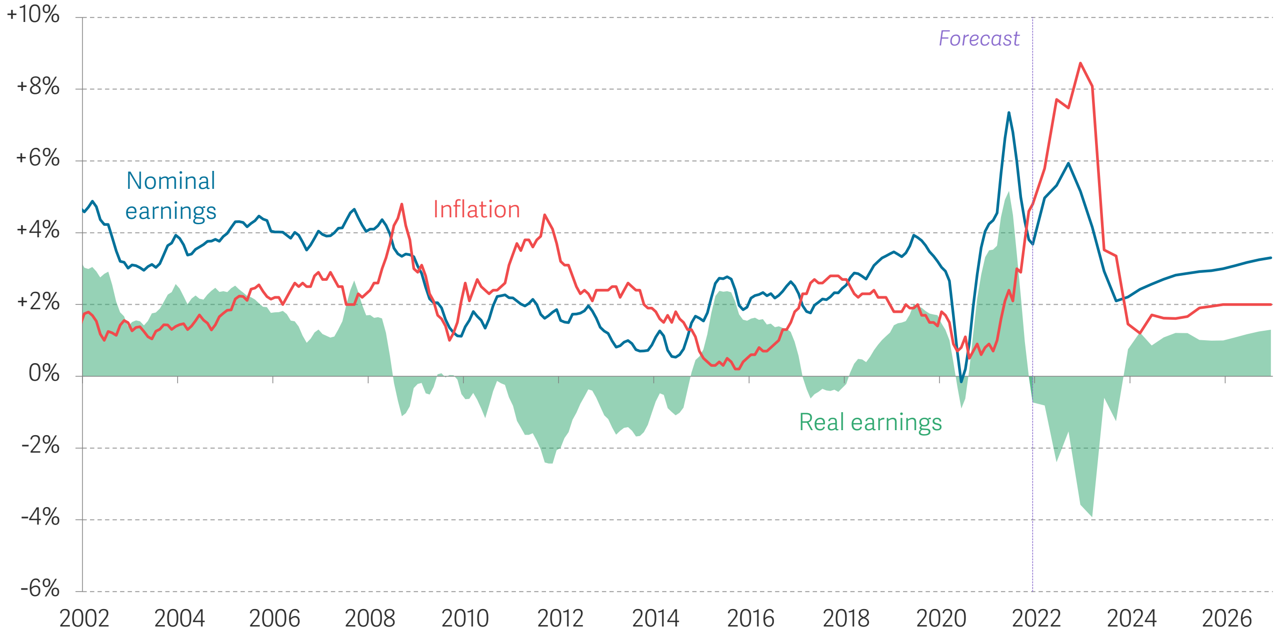
SOURCE: RF analysis of ONS, Labour market statistics; OBR, Economic and fiscal outlook, various; Bank of England, Monetary Policy Report, February 2022.

A contributor to the optimism about this 'immaculate disinflation' not materially raising unemployment is the view that, despite a rise in wage growth in the near term, workers are expected to acquiesce to the huge rise in the cost of living by accepting a cut to their real wages. In particular, the OBR expects the tight labour market to drive up nominal wage growth in the short term: wages are expected to grow by 5.2 per cent in 2022 as a whole (Figure 4). But beyond 2022, the OBR's forecasts show no sign of the wage-price spiral feared by some policy makers in recent months: wage growth is expected to fall below 3 per cent in the medium term, before stabilising at 3.2 per cent in 2025.[6] The result is workers facing imminent, large falls in their living standards, as pay packets fail to keep pace with rising prices. Indeed, as Figure 4 shows, real wages are set to fall by 3.6 per cent over the course of 2022, driven by high inflation, and will not return to year-on-year growth until the end of 2023.

6 S P Chan, Don't ask for a big pay rise, warns Bank of England boss, BBC News, February 2022.

FIGURE 4: **Despite strong nominal wage growth, real wages are set to fall until the end of 2023**

Annual growth in average weekly earnings (regular pay) and CPIH inflation, outturn and projections: GB/UK



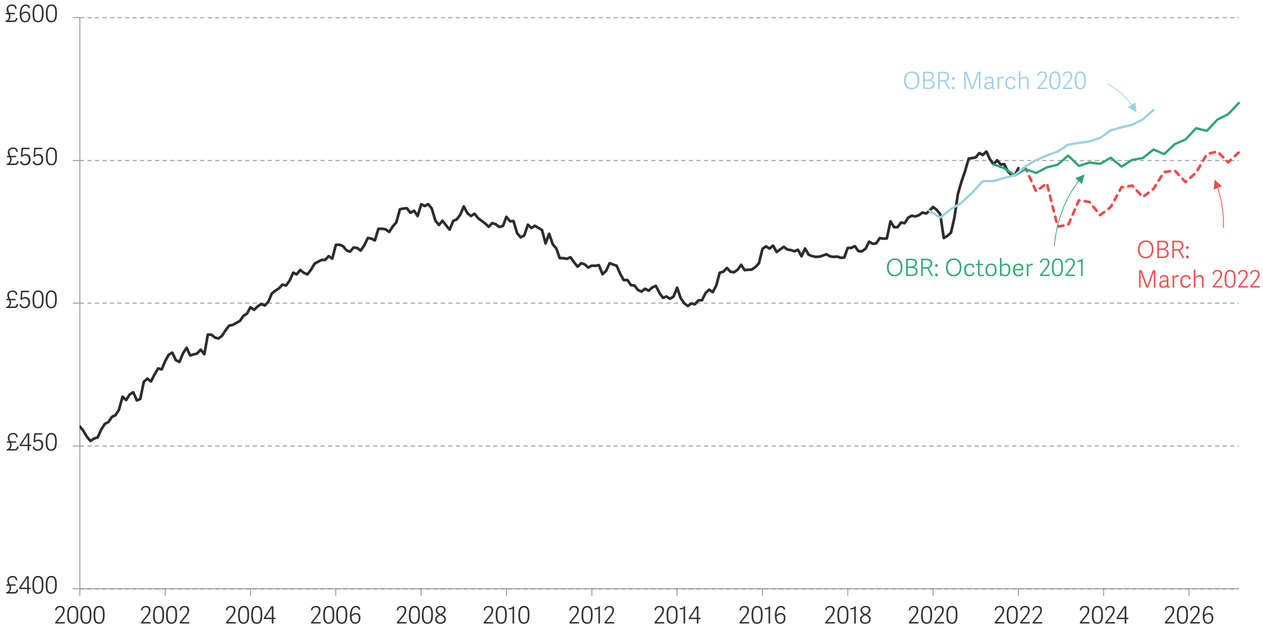
NOTES: Average weekly earnings growth is year-on-year change in quarterly whole economy average, regular pay (i.e. excludes bonuses), adjusted for CPIH inflation. Projections apply the OBR's forecast of average earnings and CPI inflation. Earnings outturn data covers Great Britain; earnings growth forecast and all inflation data covers the UK.
SOURCE: RF analysis of ONS, Labour market statistics; OBR, Economic and fiscal outlook, March 2022; ONS, Consumer price inflation.

By the time real wages start growing again in Q4 2023, earnings will be no higher on average than they were in 2007, as shown in Figure 5. And even when pay starts growing again, real wages will not return to their April 2021 peak until Q3 2026, in four-and-a-half years' time. By 2027, real wages are set to have grown by just £18 a week since the financial crisis, compared to £240 a week if they had grown in line with the pre-financial crisis trend.[7]

7 For the earnings analysis in this section, we use the outturn for average weekly earnings (AWE) regular pay (i.e. excluding bonuses), and then apply the OBR's earnings growth rate to this outturn. This means that we get slightly different pay levels and trends to the OBR. Notably, our analysis shows real returning to its pre-financial crisis peak sooner than the OBR series – this is because Q1 2008 (when the OBR's earnings series begins) was a spike in total pay (but not regular pay), meaning that comparing total pay to this baseline looks relatively pessimistic.

FIGURE 5: **Real wages are set to have grown by just £18 a week between 2008 and 2027**

Average weekly earnings, adjusted for CPIH inflation (2021-22 prices), outturn and OBR projections: GB/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. Earnings outturn data covers Great Britain; earnings growth forecast and all inflation data covers the UK.
SOURCE: ONS, Labour market statistics; OBR, Economic and Fiscal Outlook, various; ONS, Consumer price inflation.

The key judgement underlying this forecast is that only a small rise in unemployment is needed to pressure workers into accepting a big fall in real wages. The upshot is a sanguine picture for unemployment but a huge hit to living standards. And, as discussed below, the main new announcements in the Spring Statement are the Chancellor's response to that hit.

The Chancellor has taken steps to cushion the blow of rising prices, but with a package that does little for low-income households

The Chancellor has responded to the higher inflation with a significant, if poorly targeted, package of support with a set of measures that do more to improve his (apparent) tax-cutting credentials than to help the households most affected by the rising cost of living. The measures taking effect in 2022-23 – which will cost just over £9 billion, just over £8 billion of which is directly supporting households' living standards – are:

- A substantial increase in the starting point for employee and self-employed National Insurance (NI) in July 2022, taking the threshold from £9,880 to £12,570 where it will be aligned with the Income Tax personal allowance. Like the Income Tax personal allowance, it will then be frozen until 2026.[8]

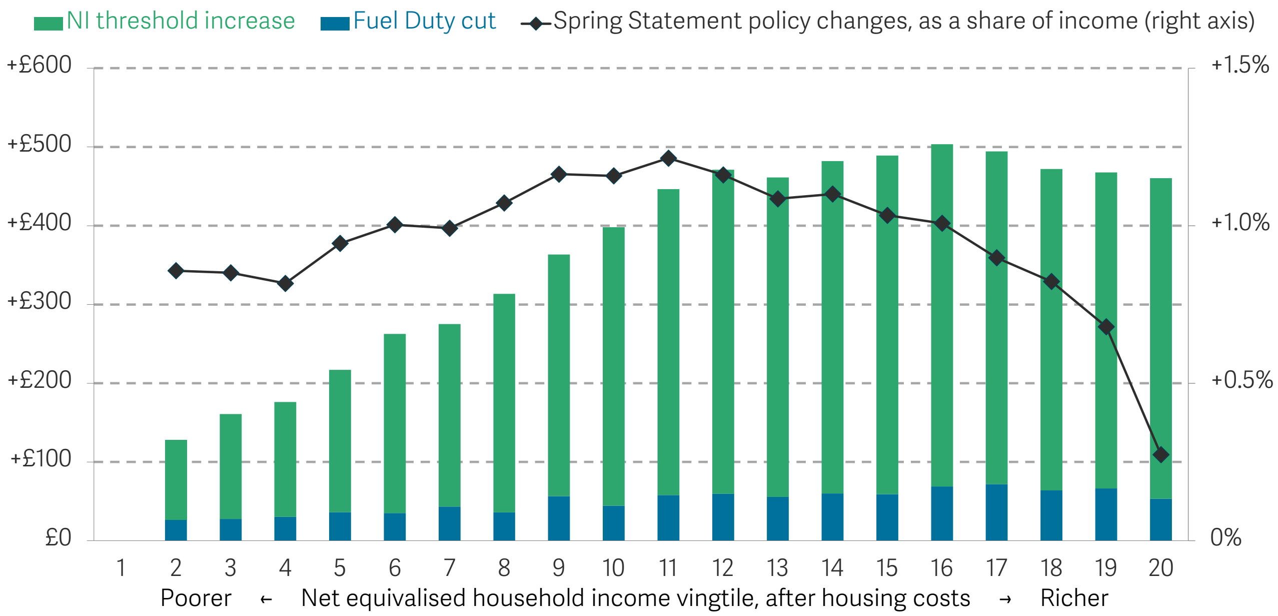
8 There was also a rise in the Employment Allowance, which lowers some employers' liability to employer NI; we discuss this towards the end of this note.

- A one-year reduction in Fuel Duty rates, from 57.95 to 52.95 pence per litre, taking them to their lowest nominal rate since 2009, and their lowest real rate since 1995. If passed on in full, this will save a typical household that drives £75 a year, but would reverse only 13 per cent of the increase in pump prices over the past year.
- A £500 million increase to the discretionary Household Support Fund, extending its operation into 2022-23.

As a whole, the package of immediate support is significant but very poorly targeted at those most likely to struggle with the rising cost of living: only £1 in every £3 announced yesterday will go to the bottom half of the income distribution. This is partly because the higher NI threshold is of no help to those who are not working or earn less than the current NI threshold, and partly because the cash gains from the cut in Fuel Duty are worth more to higher-income households who drive more (55 per cent of the bottom income decile do not drive). As a result, as Figure 6 shows, middle-income households gain most as a share of income from the newly-announced measures for 2022-23. The average gain across the top half of the income distribution is £475, compared to a gain of just £136 for the poorest fifth of households.[9]

FIGURE 6: **Middle- and higher-income households are the biggest gainers from the Spring Statement measures announced to deal with the cost of living**

Impact on household incomes of policies announced in the Spring Statement and taking effect in 2022-23, by income vingtile: UK



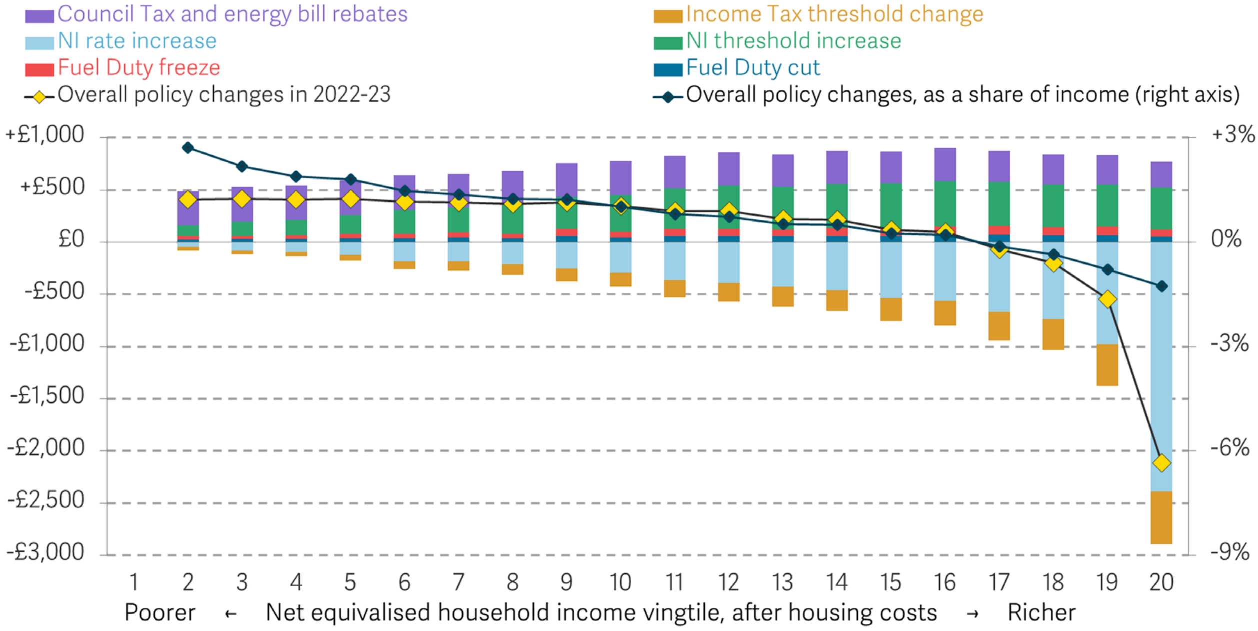
NOTES: We exclude the bottom 5 per cent due to concerns about the reliability of data for this group.
SOURCE: RF analysis of DWP, Family Resources Survey, using the IPPR Tax Benefit Model; ONS, Living Costs and Food Survey.

9 These figures exclude the impact of the Household Support Fund, as it is not clear who will benefit from this.

These new measures are in addition to support announced in February to ameliorate April's rise in the energy price cap (a £150 Council Tax rebate for Band A to D properties, and a £200 Energy Bills Rebate, to be recouped through higher bills in future years),[10] but also come on top of tax rises announced in previous Budgets that take effect in April (the increase in the rate of NI by 1.25 percentage points, and the freeze to the Income Tax personal allowance and higher-rate threshold). The impact of this combined set of changes for 2022-23 look more progressive. As shown in Figure 7, the majority of households gain from the package to help with April's energy price cap rise, while higher-income households lose out significantly from the higher rate of NI and the freeze to the Income Tax personal allowance and higher-rate threshold. If we consider just the changes to Income Tax and NI due in 2022-23 and reflect that the NI threshold will not fall until July, earners on less than £25,000 will gain, and those above will lose from all the measures being introduced in the next fiscal year (if the NI threshold had fallen in April, this cut-off point would have risen to £32,000). Overall, the gain for a typical household is £323 but households in the top half of the income distribution will be worse off by £169 on average.

FIGURE 7: **Pre-announced tax rises mean that the combined impact of all changes due to take effect in 2022-23 hit higher-income households harder**

Impact on household incomes of policies taking effect in 2022-23, by income vingtile: UK



NOTES: We exclude the bottom 5 per cent due to concerns about the reliability of data for this group. National Insurance impact excludes the employer rate.
SOURCE: RF analysis of DWP, Family Resources Survey, using the IPPR Tax Benefit Model; ONS, Living Costs and Food Survey.

10 A Corlett et al., The price is right? The April 2022 energy price rise and the Government's response, Resolution Foundation, February 2022.

With typical energy bills about to rise by £58 a month in April, and with the prospect of a rise of a further £69 a month in October, it is clear from the cash figures in Figure 7 – which shows that the support package is worth around £400 a year for households in most of the vingtiles in the bottom half of the distribution – that the measures announced by the Chancellor are far from adequate for poorer households.[11] In particular, it is very surprising that he did nothing to address the £11 billion real terms cut in benefits that will take place in 2022-23, caused by using a lagged measure of inflation.

We show later the impact of the Chancellor's decision on real incomes in 2022-23, but Figure 8 illustrates how three stylised family types could see their incomes change between September 2021 and September 2022. A couple with two earners will see their income fall in real terms over this period, with the higher NI threshold, the support package announced to deal with energy bills and wage growth being not quite sufficient to offset the higher cost of living. For working-age families on UC, income changes since last September will be affected by the expiration of the £20-per-week boost to UC, which left around 6 million families worse off by over a £1,000 per year. For those on UC and in work, though, the cut in the UC taper rate and increase UC work allowances led to higher benefit awards. This can be seen in our example families below, where the extra support from the lower UC taper means that annual income changes constitute a fall of 3 per cent for a single parent working 20 hours a week, but an out-of-work individual reliant on benefits will have a level of income in September 2022 that is almost one-sixth (15 per cent) lower than a year earlier.

11 The OBR has assumed that annual energy bills will rise to £2,800 after the October 2022 price cap change, although these predictions are based on wholesale futures prices from late February and early March when prices were especially elevated following the invasion of Ukraine.

FIGURE 8: **The support package announced for 2022-23 does nothing to support incomes for low-earning and out-of-work individuals**

Family income changes for three example families from September 2021 to September 2022: UK

Individual or family circumstance	Single person out-of-work, renting a shared room	Single parent with one child, working 20 hours per week at a low-medium wage, renting	Couple both working full-time at the median wage
September 2021 annual income	£9,054	£18,265	£38,065
End of £20 per week UC boost	-£1,040	-£1,040	£0
Cost of living rise to September 2022	-£557	-£1,198	-£2,648
Wage increases	£0	+£167	+£1,559
Lower UC taper rate	£0	+£878	£0
Benefit uprating	+£99	+£197	£0
NI rate increase	£0	-£9	-£362
Higher NI thresholds	£0	+£95	+£733
Energy support measures	+£163	+£326	+£326
September 2022 annual income	£7,718	£17,681	£37,672
Total real change in income	-£1,336	-£584	-£392
Total change (%)	-15%	-3%	-1%

NOTES: Single person renting shared room assumed to only benefit from half of the energy support measures. Cost of living rise calculated using OBR forecast inflation for Q3 2022 (including Fuel Duty cut). All figures in 2021-22 prices.
SOURCE: RF Case Study Model.

In addition to the main measures discussed above, the Chancellor did announce some small changes to reduce our dependence on expensive fossil fuels. Zero-rating VAT on domestic insulation and clean heat sources will lessen the cost for households with the means to invest in their homes, but the seven-in-ten of the poorest homeowners who live in properties with an EPC D rating or below are likely to be excluded,[12] and upgrading homes is unlikely to happen at the pace needed to prevent the four-in-five families living in the leakiest homes falling into fuel stress as bills rise.[13]

12 A Corlett and J Marshall, Shrinking Footprints, Resolution Foundation, March 2022
13 A Corlett, L Judge and J Marshall, Higher and Higher, Resolution Foundation, January 2022

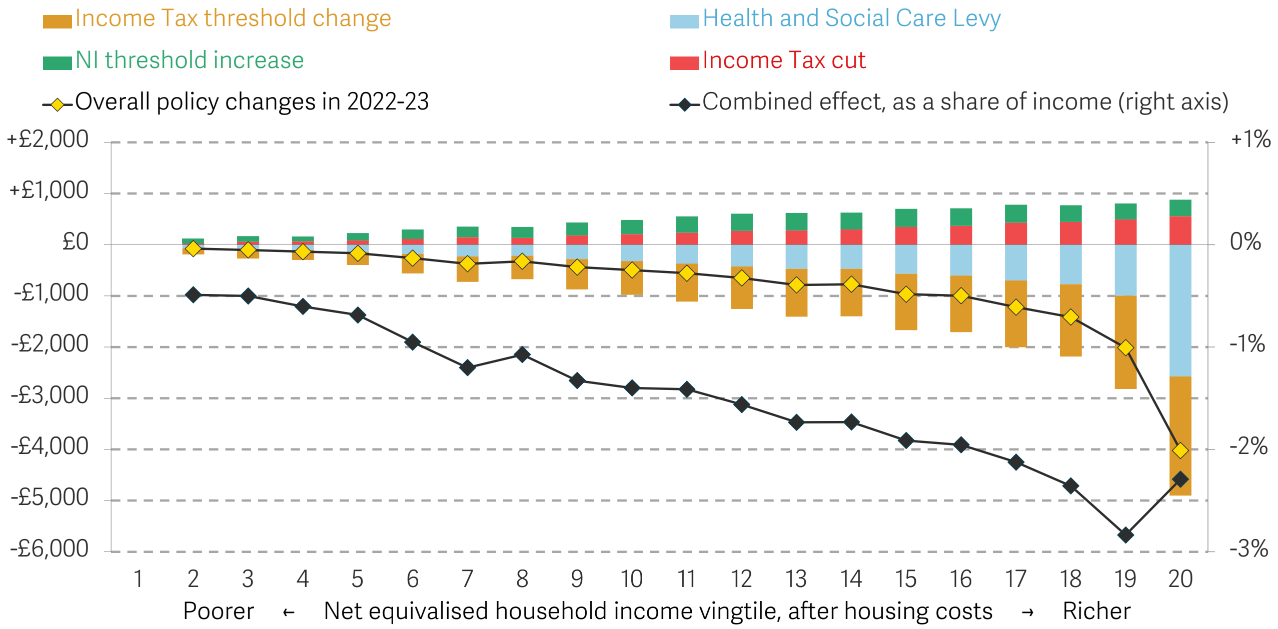
A surprise Income Tax cut from 2024-25 will be more than offset by the cumulative impact of frozen personal allowance and higher-rate thresholds

The Chancellor's 'rabbit-out-of-the-hat' was a 1p cut in the basic rate of Income Tax (reducing it to 19 per cent) from April 2024.[14] This will save an average earner £243 at that point, and together with the higher NI threshold announced yesterday, represents a significant give-away to better-off households in that year.

However, these two new tax giveaways are more than offset by the significant tax rises already announced by the Chancellor for 2024-25, the freeze in Income Tax personal allowance and higher-rate threshold, and Health and Social Care Levy. The combined effect in 2024-25 of these personal tax changes announced by Rishi Sunak is shown in Figure 9: households in the middle of the income distribution will be £535 a year worse off, but losses among the richest ten percent are above £2,000 a year, over 2 per cent of disposable income.

FIGURE 9: **The cut to the basic rate of tax in 2024-25 is more than offset by already-announced direct tax rises**

Impact on household incomes of direct tax changes taking effect in 2024-25, by income vingtile: UK



NOTES: We exclude the bottom 5 per cent due to concerns about the reliability of data for this group. National Insurance impact excludes the employer rate.
SOURCE: RF analysis of DWP, Family Resources Survey, using the IPPR Tax Benefit Model.

14 This will not apply in Scotland, as many Income Tax parameters are devolved.

These losses are driven by the cumulative impact of the decision to freeze the Income Tax personal allowance and higher-rate threshold at a time when inflation is very high (the high inflation between now and 2024-25 also reduces the generosity of July's increase in the NI threshold, as that will then be frozen until 2026). Considering Income Tax alone, only those earning between £49,100 and £50,300 pay less tax in 2024-25; considering Income Tax and NI, the only people paying less are those earning between £11,000 and £13,500. Of the around 31 million people in work, around 27 million (86 per cent, on unrounded numbers) will pay more in Income Tax and NI in 2024-25 thanks to changes announced since Rishi Sunak became Chancellor.

Overall, the Chancellor's reforms to Income Tax and NI will, by 2024-25, have succeeded in aligning the point at which people start to pay Income Tax and NI. This is a helpful, if small, simplification to the personal tax system. This new combined threshold will be higher in real-terms than the NI threshold of 2019-20, but lower than the Income Tax personal allowance of 2019-20.

What makes less sense is how the rates of these two taxes will have changed, and the implications this has for the rate of tax of different sorts of economic activity. By 2024-25, the basic rate of Income Tax will have fallen by 1 percentage point, but this will have been more-than-offset by a new 1.25 percentage point Health and Social Care Levy. The combined effect will have been to increase the main rate of tax paid on earned income (by 0.25 percentage points), but to have lowered the main rate of tax on unearned income other than that from dividends (by 1 percentage point). As we argued when the Health and Social Levy was announced, this is not a sensible reform.[15] It means that working-age people are more likely to see a higher marginal tax rate than people in retirement on the same level of income; it means a lower tax rate for landlords than most workers; and, when considered with the rise in the employer NI rate announced alongside the Health and Social Levy, it increases the tax distortion in favour of self-employment over employment.

Households are set for very large real income falls in 2022-23, to an extent that is unprecedented outside of recessions

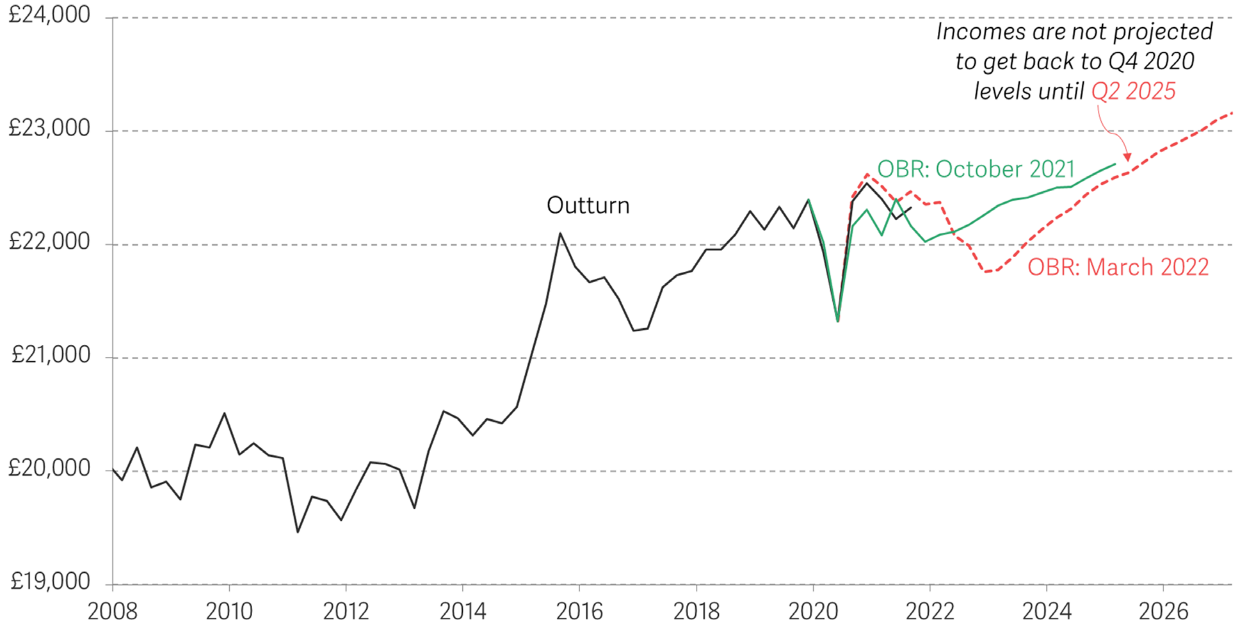
Even after the measures announced yesterday and discussed above, the outlook for real household incomes is sobering. Using the Real Household Disposable Income measure, the OBR forecasts that average real per person income will be 2.2 per cent lower in 2022-23 than in 2021-22. This equates to an average fall of £1,200 per household, and is the biggest financial year drop on record (going back to 1956-57). (The OBR notes that the drop would have been around 1 percentage point larger without the rebates and tax cuts

15 T Bell et al., Nationally Insured? New taxes and new spending to address key Department for Health and Social Care priorities, Resolution Foundation, September 2021.

announced over the past two months.) On these forecasts, real incomes will not return to their previous (Q4 2020) peak until Q2 2025 – meaning four-and-a-half years of lost income growth (see Figure 10).

FIGURE 10: **The OBR forecasts a very large hit to disposable incomes this year, which may take years to recover from**

Average Real Household Disposable Income per person: UK



NOTES: Includes non-profit institutions serving households (NPISH).
SOURCE: ONS, and OBR, Economic and Fiscal Outlook, various.

These aggregate-based forecasts tell us about average (i.e. mean) household incomes. But we can zoom in by modelling the effect of economic forecasts and government policies on disposable incomes (after housing costs) across the income distribution.[16] Based on the OBR's new forecasts for inflation, pay, housing costs and more, and looking at non-pensioner household incomes,[17] we project that the typical real income will be 4 per cent lower in 2022-23 than in 2021-22: a fall of £1,100.[18] This would be the worst hit to living standards since 1975, as Figure 11 shows. We project a further fall in working age incomes in 2023-24 (of 2 per cent), leaving typical household incomes £1,500 lower than in 2021-22. There is some recovery beyond 2023-24, however, with projected growth of 2 per cent in 2024-25 – aided by the new Income Tax cut.

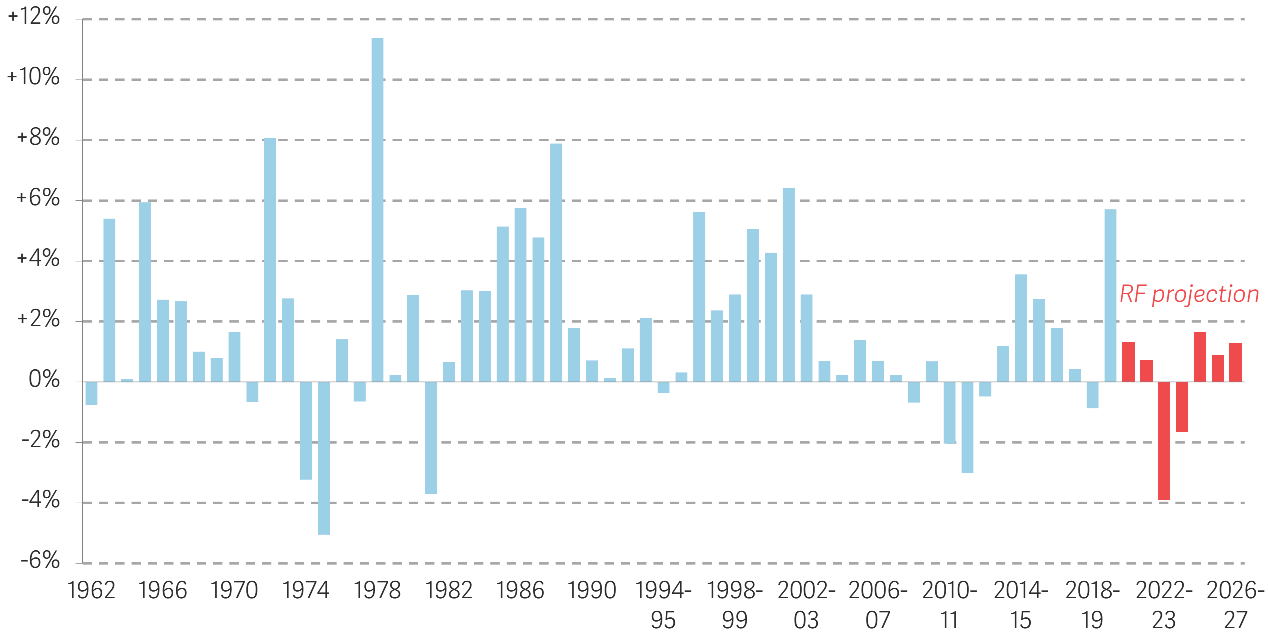
16 For more information on our approach, see: A Corlett & L Try, The Living Standards Outlook 2022, March 2022, Resolution Foundation.

17 Our modelling focuses on non-pensioner incomes due to the added complexities of predicting future private pension income, for example.

18 This compares to a very similar forecast of 4 per cent in A Corlett & L Try, The Living Standards Outlook 2022, March 2022, Resolution Foundation. The new National Insurance threshold rise (which boosts incomes) is offset by an even-higher inflation forecast and large increases in mortgage interest costs (which are projected to rise by 60 per cent – from a low base – between 2021-22 and 2023-24), among other factors. The change in mortgage costs is also an important cause of the difference between this after housing costs income projection and the OBR's RHDI forecast (which deals with housing costs in different ways), with mortgagors facing the largest typical income falls of any tenure group in 2022-23.

FIGURE 11: **Despite the Chancellor's announcements, 2022-23 is still projected to deliver the biggest hit to typical household incomes since the mid-1970s**

Annual real growth in median equivalised household disposable income for non-pensioners, after housing costs: GB/UK

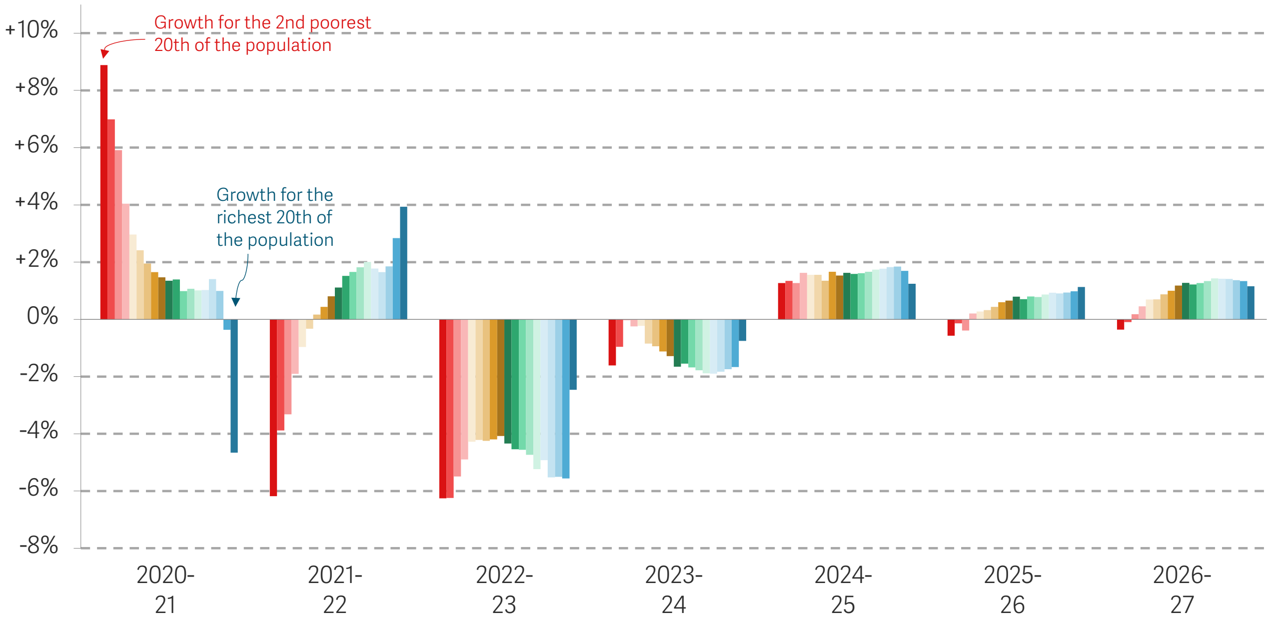


NOTES: Projections after 2019-20. Data source changes in 1994-95. GB from 1994-95 to 2001-02. See A Corlett & L Try, The Living Standards Outlook 2022, March 2022, Resolution Foundation for details of our projection methodology.
SOURCE: RF analysis of DWP & IFS, Households Below Average Income; and RF projection including use of the IPPR Tax Benefit Model, ONS data, and OBR forecasts.

Looking beyond the median, Figure 12 sets out projected growth for non-pensioner households of all income levels in each year. In fact, the change in income at the median gives an optimistic impression of what is likely to happen next year, with changes at other income levels generally even worse. The greatest hit is for those on the lowest incomes, with the average real income of the bottom quarter falling by 6 per cent relative to 2021-22. This can be ascribed to the large gap between inflation (over 8 per cent) and this April's benefit uprating (3.1 per cent), together with the fact that incomes in 2021-22 were partially supported by the £20 a week benefit boost which has now been withdrawn, as well as other ongoing reductions in the generosity of the social security system (with no increases in the benefit cap or Local Housing Allowances, for example).

FIGURE 12: **The lowest-income households are set to see the greatest income falls in 2022-23**

Annual real growth in average equivalised household disposable income for non-pensioners, after housing costs, by income vingtile: UK



NOTES: We exclude the bottom 5 per cent due to concerns about the reliability of data for this group. See A Corlett & L Try, The Living Standards Outlook 2022, March 2022, Resolution Foundation for details of our projection methodology.
SOURCE: RF projection including use of the IPPR Tax Benefit Model, ONS data, and OBR forecasts.

Among working age households where no-one is currently earning, typical income is projected to fall by 8 per cent in 2022-23. It should also be noted that this modelling is likely to understate the impact of the higher cost of living on low-income households in 2022-23 because we assume a single, shared rate of inflation for all households; in reality, the critical role of energy costs in driving inflation in the next few months means that prices are set to rise fastest for the poorest.[19] In 2023-24, incomes are generally forecast to shrink less rapidly for poorer households than the top half of the income distribution, due to benefits rising by (an expected) 7.5 per cent: this would be above inflation in that year, but would simply reflect the value of benefits catching up with the previous year's price increases.

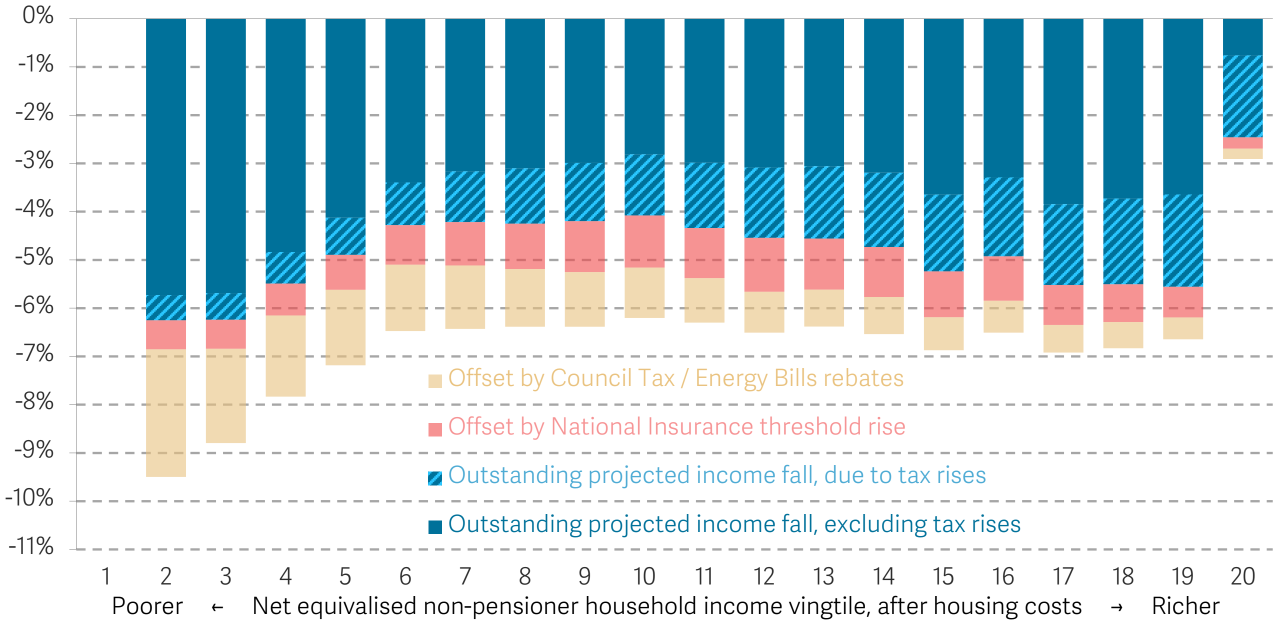
Although the projected income falls in 2022-23 are large, they would clearly have been even larger in the absence of policy interventions. As Figure 13 shows, without the policies announced at the Spring Statement and in February, typical incomes may have fallen by around 6 per cent, and the income fall for the poorest could have been as large as 9 per cent.[20] Policy has, therefore, offset around a third (34 per cent) of the potential

19 See: T Waters, Pay, prices and policy, Institute for Fiscal Studies, March 2022. The OBR breaks down the components of inflation in Chart 2.7 of OBR, Economic and Fiscal Outlook – March 2022, OBR March 2022.
20 We do not include the impact of the Fuel Duty reduction here. However, we estimate that this only reduces CPI inflation by around 0.1 percentage points in 2022-23; indeed, the OBR estimates that the Spring Statement policy package acted to *increase* inflation overall (by around 0.1 percentage points in 2022-23) as a result of increased demand.

shock for the poorer half of the population (with the £350 fuel bill rebates announced in February being more important than the NI threshold increase announced yesterday for this group), and policy has offset around a fifth (22 per cent) of the hit to the higher-income half, with the NI cut being the more important intervention there. Figure 13 also shows how much of the potential income fall would have been attributable to the NI rate rise, with policy changes more than cancelling out the impact of the rate rise for the bottom half.

FIGURE 13: **Recent policy changes have offset one third of the income shock that would have faced the poorer half of the population in 2022-23**

Projected and counterfactual real growth in average annual equivalised household disposable income for non-pensioners, after housing costs, by income vingtile, 2022-23: UK



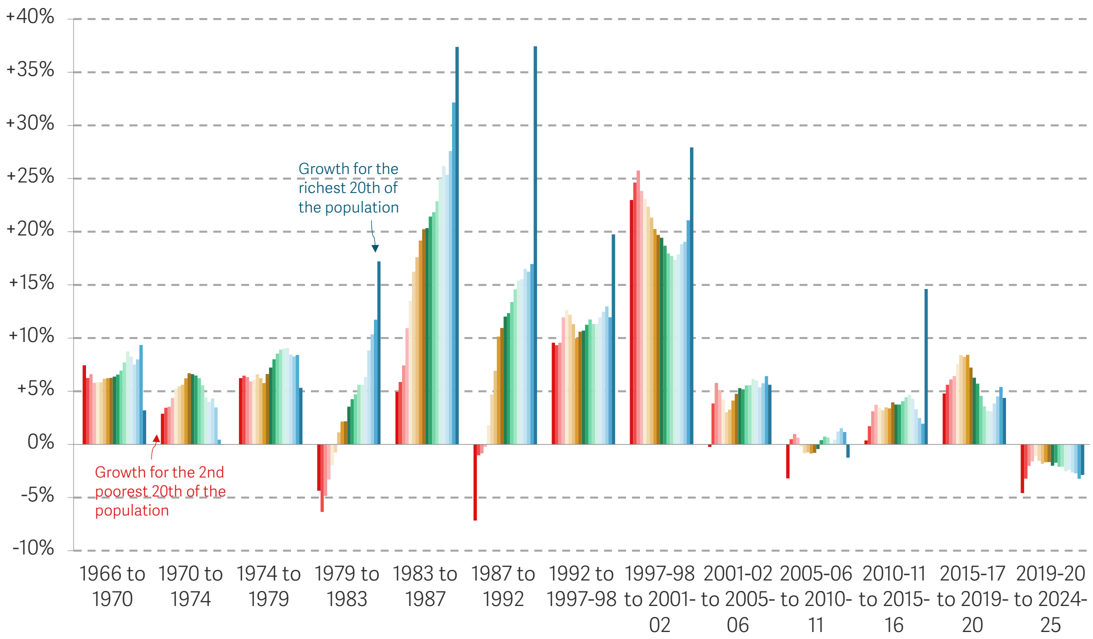
NOTES: We exclude the bottom 5 per cent due to concerns about the reliability of data for this group. See A Corlett & L Try, The Living Standards Outlook 2022, March 2022, Resolution Foundation for details of our projection methodology. 'Tax rises' refers to the NI rate rise and the Income Tax threshold freeze, and shows what the impact would have been without any changes to the NI threshold.
SOURCE: RF projection including use of the IPPR Tax Benefit Model, ONS data, and OBR forecasts.

On current projections, this would be the weakest Parliament for living standards growth on record

Although incomes are forecast to grow in 2024-25 (aided by the Income Tax cut) and future years (driven by growing real wages), the outlook over the next few years taken together is very poor. Across the distribution, real incomes are projected to be lower in 2026-27 (the end of the OBR's forecast window) than in 2021-22, meaning at least half a decade of lost living standards growth. If we look at the approximate (expected) period between general elections, from 2019-20 to 2024-25, income growth is also projected to be negative across the distribution: the typical non-pensioner income is projected to be 2 per cent lower in 2024-25 than five years earlier. As Figure 14 shows, such an outcome would make this the worst parliament on record for living standards growth (the typical income fell by 1 per cent between 2005-06 and 2010-11, for example).

FIGURE 14: **The five years from 2019-20 to 2024-25 are currently projected to be the worst parliament ever for changes in household incomes**

Total real growth in median equivalised household disposable income per period for non-pensioners, after housing costs, by income vingtile: GB/UK



NOTES: We exclude the bottom 5 per cent due to concerns about the reliability of data for this group. See A Corlett & L Try, The Living Standards Outlook 2022, March 2022, Resolution Foundation for details of our projection methodology. Some periods are four years long and others five years. The chosen time periods correspond to the years of past general elections (plus 2024), but we do not include a division for the 2017 election and nor do we try to estimate growth over the February to October parliament of 1974.
SOURCE: RF analysis of DWP & IFS, Households Below Average Income; and RF projection including use of the IPPR Tax Benefit Model, ONS data, and OBR forecasts.

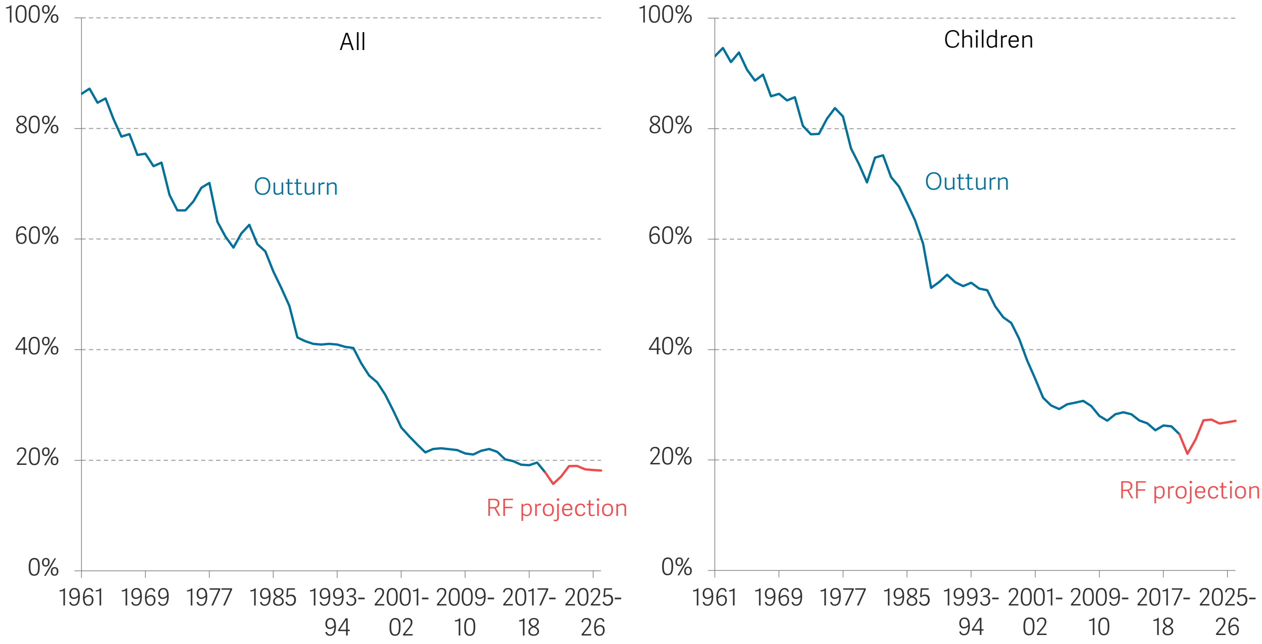
The same outcome is found with the OBR's Real Household Disposable Income forecast (shown earlier in Figure 10). Using that different measure (and even ignoring an under-performance in the ONS's outturn data), the mean real income per person is forecast to be 0.4 per cent lower in Q2 2024 than in Q4 2019: the worst growth rate over a parliament (both overall and per year) since at least the start of this series in 1955 (indeed, on this measure this would be the only parliament to record a fall in average real income).

The weak income forecast, and the particularly weak short-term outlook for the poorest households, is also reflected in our projections for absolute poverty. The historic norm is for absolute poverty rates to fall over time, but our modelling points to an increase in 2021-22 (reversing falls produced by benefit increases in 2020-21); a further large rise in

2022-23; and little progress thereafter (see Figure 15). As the Chancellor has not opted to additionally increase benefits this year, the number of people living in absolute poverty is projected to rise in 2022-23 by 1.3 million, including 500,000 children. Small falls are projected after 2023-24, but this would still leave the share of people and children in absolute poverty higher in 2026-27 than in 2019-20. (Relative child poverty, meanwhile, is projected to rise to rates not seen since the record-breaking 1990s, with 33 per cent of children living in relative poverty by 2026-27.)

FIGURE 15: **Absolute poverty is likely rising, and no progress is expected over this parliament as a whole**

Proportion of people/children living in absolute poverty, after housing costs: GB/UK



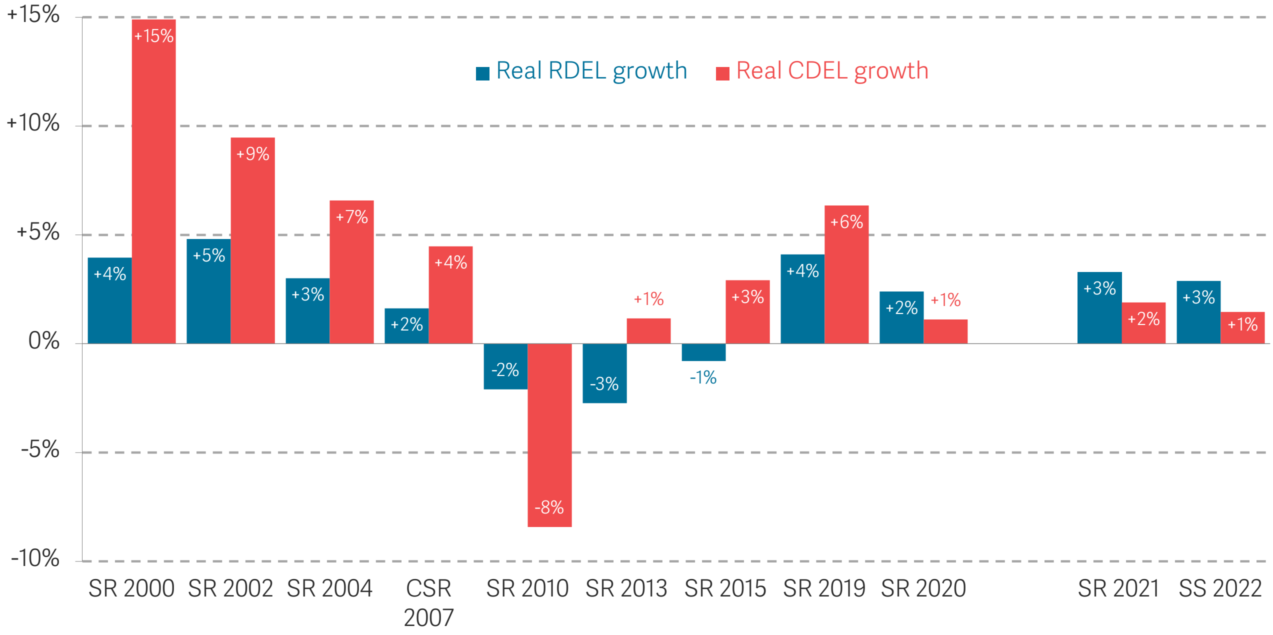
NOTES: Data source changes in 1994-95. GB prior to 2001-02. See A Corlett & L Try, The Living Standards Outlook 2022, March 2022, Resolution Foundation for details of our projection methodology.
SOURCE: IFS, Living standards, poverty and inequality in the UK; RF analysis of DWP, Households Below Average Income; and RF projection including use of the IPPR Tax Benefit Model, ONS data, and OBR forecasts.

Higher inflation will reduce the spending power of government departments

Although the OBR projects CPI to peak at 8.7 per cent in 2022-23, the fact that this is driven by imported goods – particularly oil and gas – means that inflation is set to have a much smaller impact on the real value of public spending than some had feared. In particular, the OBR projects GDP deflator inflation to be half the rate of CPI inflation: just 4 per cent in 2022-23. This means that the generosity of the Chancellor's spending plans – outlined in the Spending Review in October – are reduced but not hugely so. As shown in Figure 16, the 3.3 per cent annualised real increase in total (non-Covid related) day-to-day spending planned between 2021-22 and 2024-25, has fallen to 2.9 per cent: amounting to just over £5 billion of lost spending in 2021-22 prices. Similarly, inflation will contribute to a reduced growth in capital spend from an annualised rate of 1.9 per cent to 1.5 per cent. So, if inflation does not become domestically ingrained, then both current and capital spend are set to grow in real terms over the next three years.

FIGURE 16: **Inflation means that the day-to-day increase in government spending will be slightly smaller**

Annual average change in real (2021-22 terms) RDEL and CDEL as detailed at each fiscal event: UK



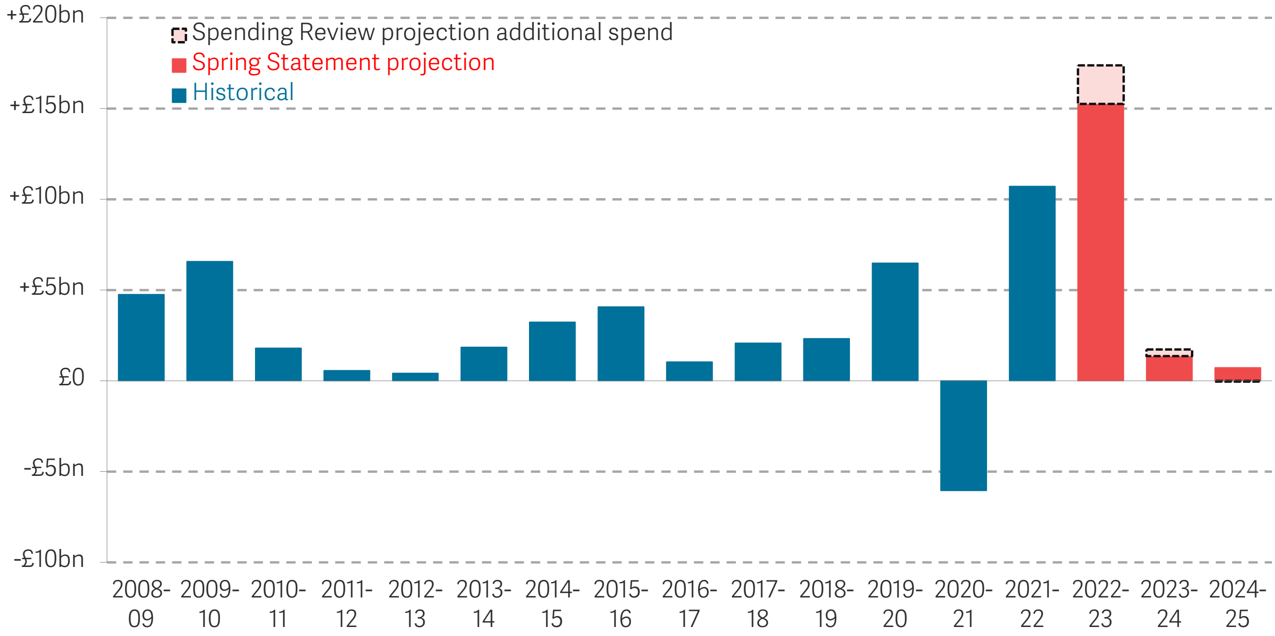
NOTES: Values are deflated by contemporaneous deflators. In 2007 there was a Comprehensive Spending Review.
SOURCE: RF analysis of HMT, PESA Tables, various, Spending Review 2021 and Spring Statement 2022; OBR, Economic and Fiscal Outlook, various.

This modest impact on the overall level of real public spending means that the big increases in funding for health and social care are projected to be largely maintained. Figure 17 charts the real change in the Department of Health and Social Care resource budget from 2008-09 to 2024-25. It shows that the higher level of domestic inflation reduces the large increase in the health budget by only £2 billion in 2022-23. And, at £15 billion, this increase remains the largest seen in recent years.

Just as departments expecting real-term increases in their budgets after the Spending Review should continue to do so, so department that were facing real-term falls also face modestly larger falls. In particular, with no new funding made available, real day-to-day spending on defence will decline by 5.7 per cent between 2021-22 and 2024-25 (a larger fall than the 4.3 per cent decline expected in October).

FIGURE 17: **Real spend for DHSC in 2022-23 will be £2 billion smaller than expected at the 2021 Spending Review**

Real (2021-22 terms) change in Department of Health and Social Care budget, historical and projected: UK, 2008-09 to 2024-25



SOURCE: RF analysis of HMT, PESA Tables, various; Spending Review 2021; and OBR, Economic and Fiscal Outlook, October 2021 and March 2022.

These modest changes to projected real government spending are predicated on domestically generated inflation remaining significantly lower than CPI. Given that almost half of departmental resource spending relates to staff pay, the fact that public sector pay is rising much more gradually than pay in the private sector may mean that this is a reasonable expectation in the short term. However, given the legacy of the past decade of pay restraint, and the ambition announced in the Spending Review that "public sector pay growth over the next three years should retain broad parity with the private sector",[21] upward pressures may be significant.

Supply bottlenecks are expected to reduce public sector investment levels

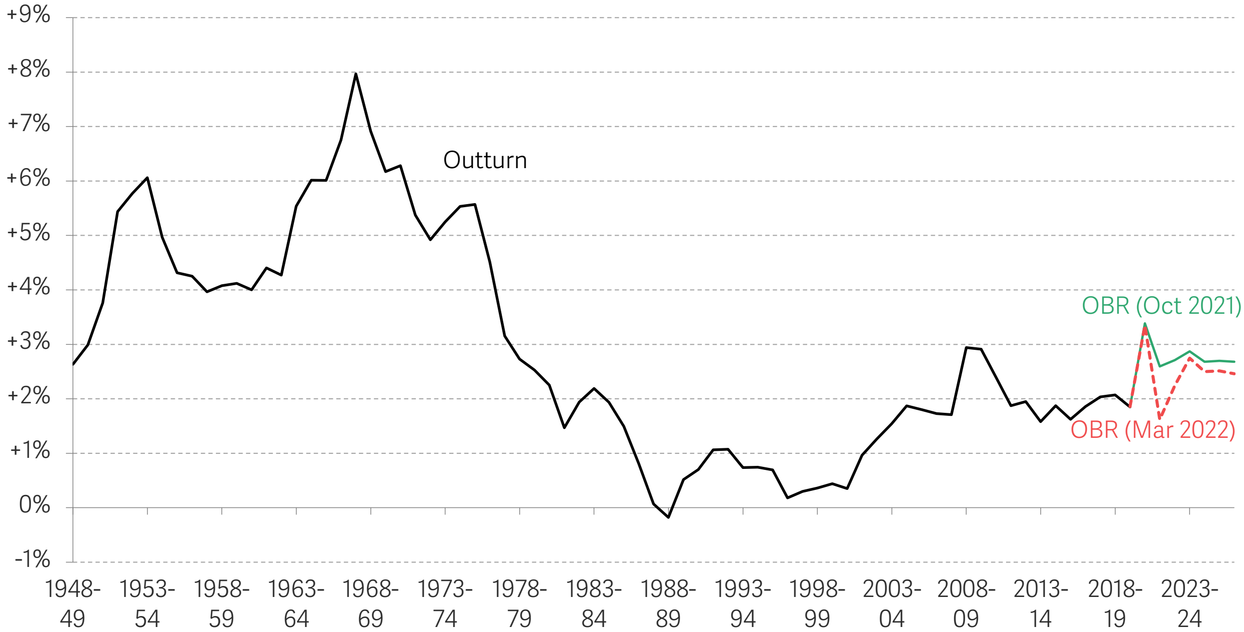
Capital spending is a key part of the Government's overall strategy to generate higher productivity and economic growth. However, given major supply bottlenecks in the economy and globally, the OBR has revised down actual capital spending in 2021-22 and 2022-23. These revisions reflect both the £8.4 billion reduction in 2021-22 CDEL that departments have agreed, as well as supply bottlenecks impacting the ability of departments to deliver on investment plans in 2022-23. Together with reductions in anticipated calls on Covid-related loan schemes, these leave public sector net

21 HM Treasury, Spending Review 2021,, October 2021.

investment (PSNI) £20 billion lower in 2021-22, and £10 billion lower in 2022-23, than forecast in October. As a result, PSNI is set to fall to 1.6 per cent of GDP in 2021-22, before rising to 2.5 per cent by the end of the forecast (see Figure 18). This leaves the Chancellor with greater headroom to increase investment and remain within his 3 per cent of GDP cap on investment. In 2021-22 cash terms, this headroom amounts to a total of £60 billion over 5 years from 2022-23 to 2026-27.

FIGURE 18: **Supply chain disruptions mean public sector investment will be more volatile than previously forecast**

Public Sector Net Investment (PSNI) as a proportion of GDP, outturn and projected: UK, 1948-49 to 2026-27



SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, October 2021; ONS, Public Sector Finances; OBR, Economic and Fiscal Outlook, October 2021 and March 2022.

Despite the challenges for households' finances, the government finances have improved

As with households, government finances are substantially affected by rising inflation. But the most important public-finance story emerging from the Spring Statement is the surprisingly rapid increase in tax revenues. As shown in Figure 19, government receipts in 2021-22 are now projected to be £38 billion higher than expected in October. This represents the second-largest-ever increase in revenue in the first year of a fiscal forecast, following hot on the heels of the largest on record which occurred in the previous OBR forecast.[22] This huge improvement in tax revenues is expected to persist throughout the forecast.

22 This is measured by changes in public sector current receipts forecasts, with comparable data going back to November 1990.

Partially offsetting the improvement in the tax forecast is an increase in government spending, driven in large part by the increase in inflation. Inflation has a direct fiscal cost through its impact on debt interest; this is both as a result of needing to pay higher interest on newly issued government debt as central banks around the world raise interest rates, and directly from paying more interest on existing index-linked gilts.[23] This effect is not small: the forecasts for spending on debt interest in 2021-22 and 2022-23 have increased by £13 billion and £41 billion respectively. However, as higher inflation is expected to be temporary, interest costs should rapidly fall back, and are expected to add only an additional £8 billion to borrowing per year by 2026-27.

Figure 19 shows how the forecasts for underlying tax and spending have changed since October. The policy measures can be largely grouped into three buckets: support for household bills; reductions in taxes paid on workers' income; and changes to student loans (announced back in February).[24]

In line with their impact on households, the aggregate fiscal cost of support measures for rising energy costs is relatively small, especially given the scale of the economic headwind (requiring just £8.9 billion in additional borrowing in 2022-23 for the council tax rebate and energy bill discount, £2.4 billion for reduced Fuel Duty and £1 billion for the Bulb Energy bailout). This cost is partially recouped in subsequent years as households pay back the energy bill reduction (although the OBR's forecasts assume that the Government keeps to its pledge to increase Fuel Duty in April 2023, something it has not done since 2011).

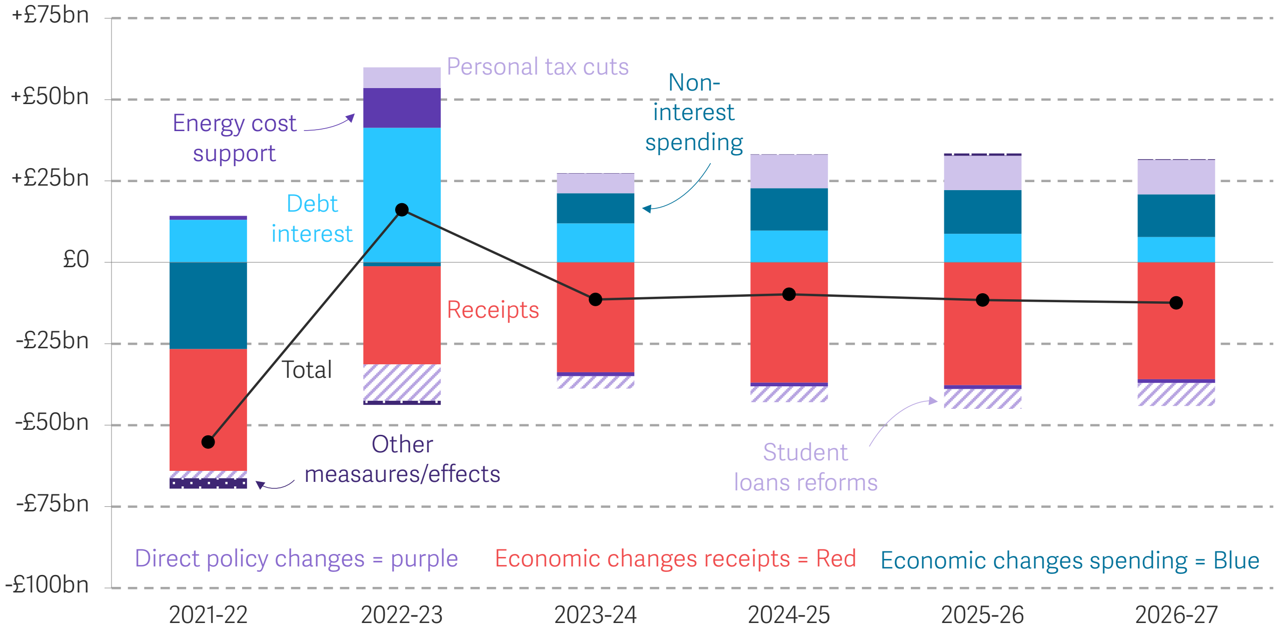
Reductions in Income Tax and NICs are material, but they have a relatively small fiscal impact, adding £10.6 billion to borrowing in 2026-27, which is largely offset by the impact of the student loans reforms. This means that just 17 per cent of the underlying improvement in the fiscal forecast has been 'spent' by the Chancellor on net giveaways to households and businesses by the end of the forecast.

23 Index-linked gilts are linked to the Retail Price Index; when inflation rises, this requires an increase in interest payments from the government. These payments are measured on an accrual basis, and so most of the actual additional payments on these bonds will not come for many years, but they are recognised in government borrowing upfront. Index-linked gilts make up a little under a quarter of outstanding UK government debt. For more detail, see: OBR, Fiscal risks report, July 2021.

24 Changes to student loans were significant and have a complicated impact on government finances. The net changes reduce measured government borrowing because a higher share of the total cost of students' education will be paid for by students and the proportion of loans written-off (which is reflected in borrowing upfront) falls. For more detail, see: OBR, Economic and Fiscal Outlook, October 2021.

FIGURE 19: **Increases in underlying tax receipts more than offset higher debt interest costs and tax cuts**

Change in the OBR's forecast of public sector net borrowing: UK, October 2021 to March 2022



SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, March 2022.

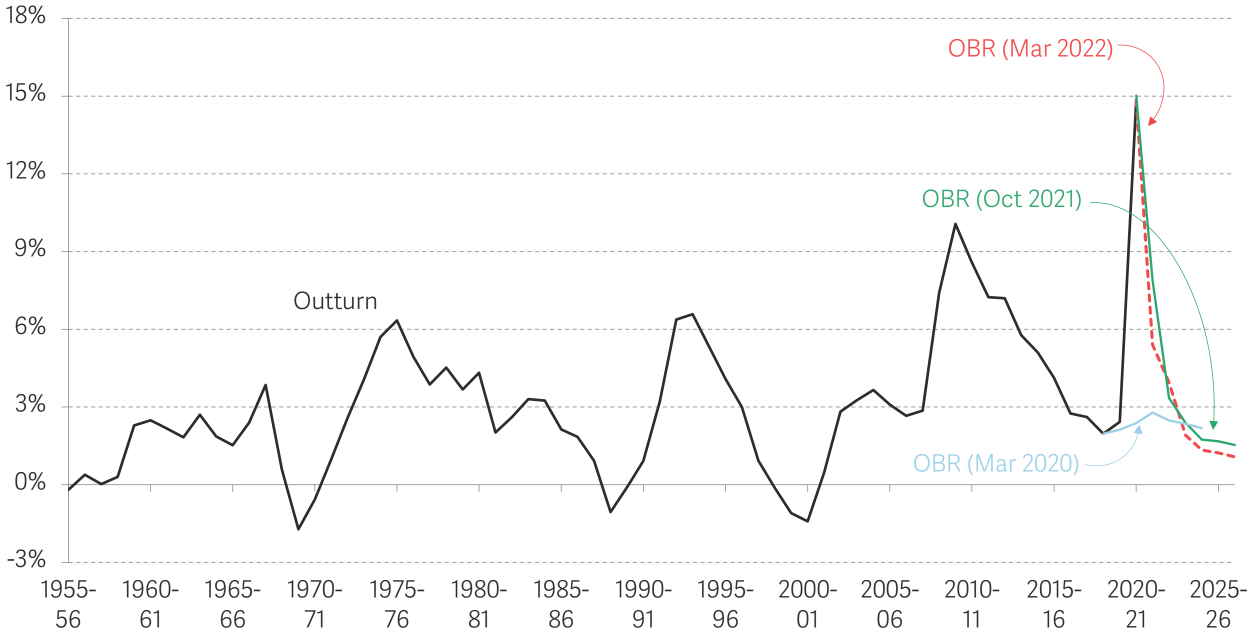
Taking everything together – higher interest costs and policy giveaways, combined with improved tax revenues – the picture is one of a material upgrade to the public finances. Cumulatively, over the forecast and before the impact of policy decisions, public sector net borrowing (PSNB) was projected to be £42.4 billion lower than expected in October; even after policy decisions, that improvement is £25.6 billion.[25] The pace of the reduction in PSNB following the pandemic peak is remarkable: PSNB, as a share of GDP, is set to fall from 14.8 per cent in 2020-21 to just 1.3 per cent in 2024-25 (Figure 20). That fall in borrowing is three-times larger than the equivalent five-year fall from the peak in the financial crisis, and would mean the deficit is set to be the lowest it has been since the era of tight fiscal policy under Gordon Brown's chancellorship (ending after the 2001 election). Indeed, the OBR now projects PSNB in 2024-25 to be 0.8 percentage points lower than the pre-pandemic forecast.

The rapid improvement in borrowing reflects a range of factors. These include: the already announced fiscal consolidation policy changes, such as the new Health and Social Care Levy, and increases to corporation taxes; the fact that higher inflation is boosting tax revenues while nominal public spending is constrained; and the success of past policies in reducing the long-term scarring impact the pandemic has had on the economy.

25 As measured in 2021-22 prices.

FIGURE 20: **Borrowing is falling even more rapidly than previously expected**

Public sector net borrowing, as a share of GDP, outturn and select OBR forecasts: UK



SOURCE: ONS, Public Sector Finances; OBR, Economic and Fiscal Outlook, October 2021 and March 2022.

A key metric to understand the likely path of future fiscal policy is how much 'headroom' the Chancellor has against his fiscal rules. As set out in the Autumn 2021 Budget, there are four rules the Government aims to meet as part of its fiscal framework.[26] These are:

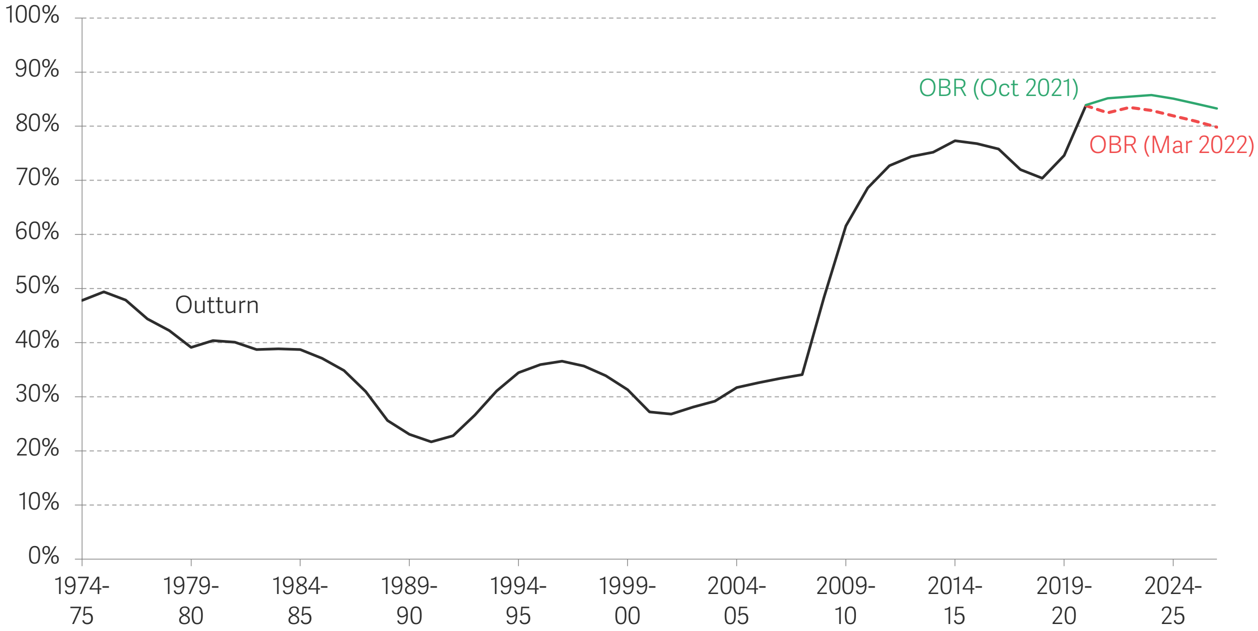
- The 'fiscal mandate' – to have public sector net debt (PSND) falling as a share of GDP in three years' time;[27]
- The 'supplementary target' – to balance the current budget in three years' time;[28]
- The 'investment limit' – to ensure that public sector net investment does not exceed 3 per cent of GDP over the rolling five-year forecast period; and
- The 'welfare cap' – to keep welfare spending below a pre-determined cap set by the Treasury.

In practice, the fiscal mandate (i.e. the debt rule) is the most constraining rule for overall fiscal decisions. As shown in Figure 21, PSND excluding the Bank of England is expected to be 81.9 per cent of GDP by 2024-25, and on a downward trajectory of 1 percentage point per year. On this measure, the amount of headroom has increased to £28 billion, or 1 per cent of GDP, in 2024-25, up from the £18 billion forecast in October 2021.

26 See Appendix A of HM Treasury, Autumn Budget 2021, October 2021.
27 For the fiscal mandate, PSND is measured excluding the impact of the Bank of England's balance sheet decisions and is targeted at the third year of the fiscal forecast on a rolling-window basis.
28 A balanced current budget means that the Government does not borrow to finance spending excluding investment net of depreciation. This is also measured at the third year of the fiscal forecast.

FIGURE 21: **Debt is expected to be on a declining path by 2022-23**

Public sector net debt, as a share of GDP, excluding Bank of England, outturn and select OBR forecasts: UK



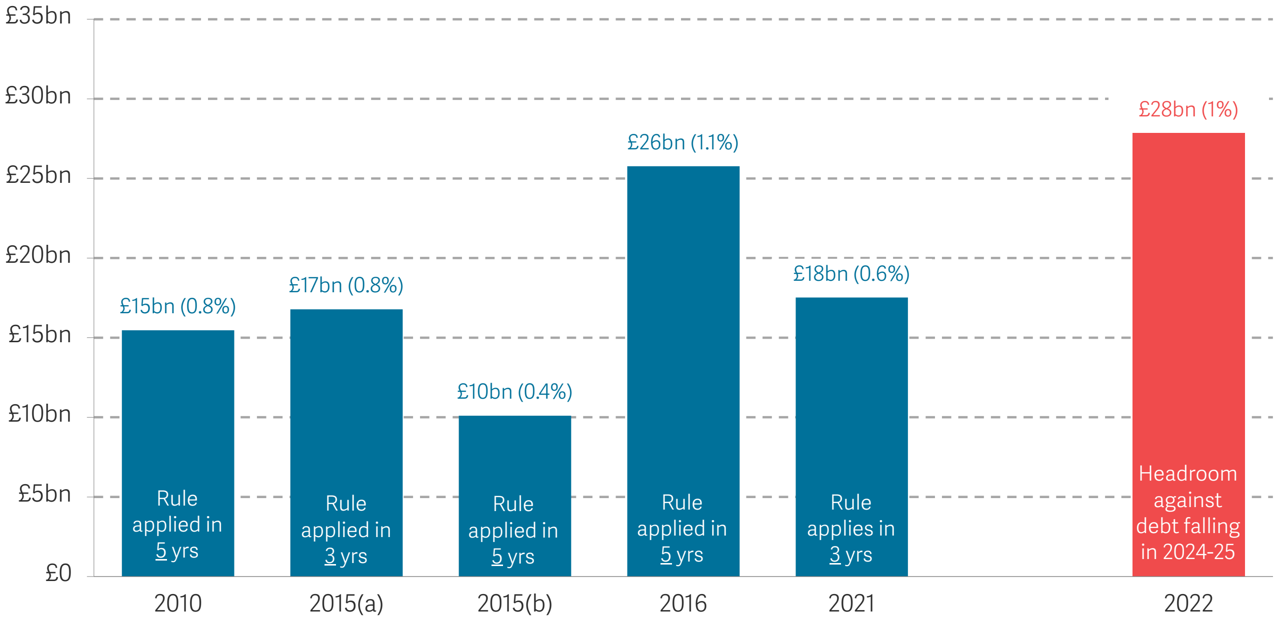
SOURCE: ONS, Public Sector Finances; OBR, Economic and Fiscal Outlook, October 2021 and March 2022.

Figure 22 puts this headroom in context: the current level is in line with, but towards the upper end of, the range of previous fiscal rule regimes. This means that, should the economy deteriorate, it would be possible for the government to provide more support without requiring the rules to be suspended. It also means that if the economy evolves in line with expectations, the Chancellor would be able to cut taxes further in the future without breaking the rules – this capacity is significant, on a simple mapping, £28 billion equates to a further 4-5p cut in the basic rate of Income Tax.[29]

29 We have highlighted in previous work that the current definition of fiscal rules can create perverse incentives to conduct pro-cyclical fiscal policy – i.e. to reduce taxes or increase spending when the economy is performing well – in contradiction to standard best practise for macroeconomic policy. For more detail on how to design effective fiscal rules, see: R Hughes et al, Totally (net) worth it: The next generation of UK fiscal rules, October 2019.

FIGURE 22: **The headroom against fiscal rules is towards the top of the range of previous rule regimes**

Headroom against fiscal rules, at previous rules' introduction and under current rules: UK

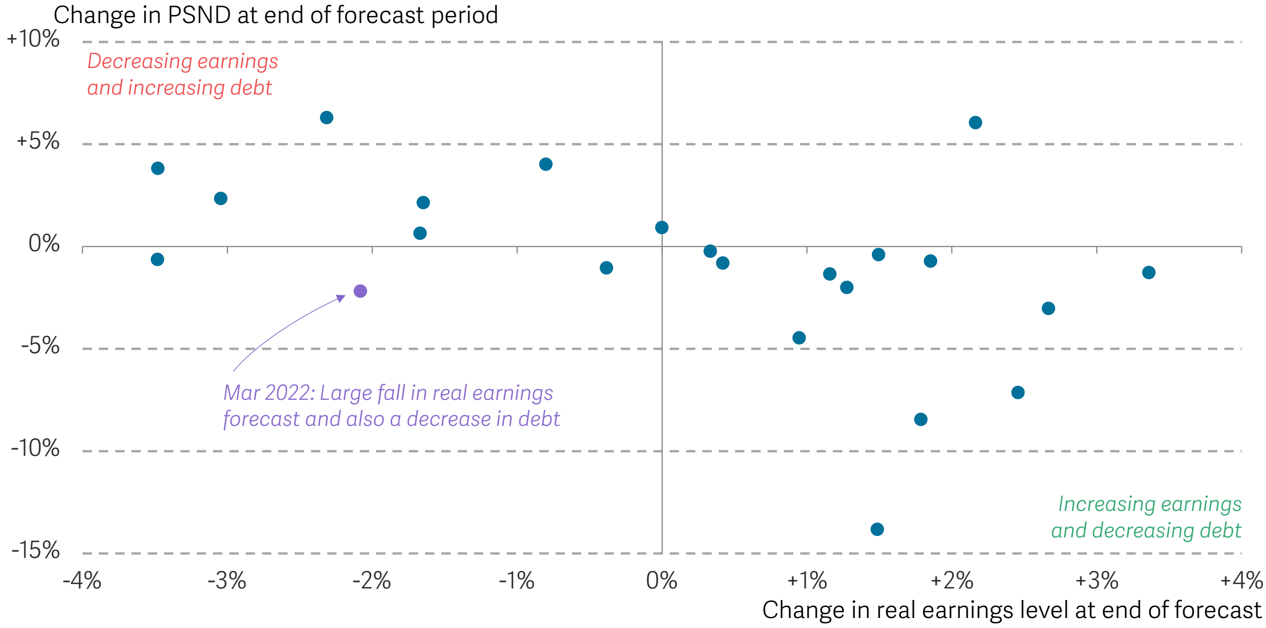


NOTES: Figures in brackets show headroom as a proportion of contemporaneous GDP. Where fiscal rules contained multiple constraints, the chart shows the headroom against the most constraining rule (in PSNB terms).
SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, October 2021; OBR, Fiscal Risks Report, July 2019; OBR, Historical Forecasts Database; OBR, Economic and Fiscal Outlook, March 2022.

It is remarkable how divergent are the paths of household and public finances: never before has the OBR downgraded its real earnings forecast over five years and at the same time reduced its forecast for government debt over the same period by more than 1 per cent. Figure 23 shows the history of these changes; the relationship is clear: when household finances deteriorate, so too do government finances, and vice versa. This relationship is driven both by the macroeconomy and typical policy responses to a changing economy. For example, a weaker economy usually reduces household incomes and government revenues at the same time as requiring greater government spending on income-related benefits and policy support measures. This time the pattern is different: real earnings are expected to be 2.1 per cent lower at the end of the forecast period than expected back in October and, at the same time, PSND is forecast to fall over the forecast period by an additional 2 percentage points.

FIGURE 23: **Normally, reductions in real earnings forecasts are accompanied by increases in public sector debt forecasts, but not this time**

Change between successive OBR five-year forecasts for real earnings and public sector net debt: UK, 2010 to 2022



NOTES: Change in PSND is defined as the revision to the change in the debt forecast between OBR forecast rounds (in other words: for each forecast period, the change in PSND between the contemporaneous year's debt figure and the projection for PSND in the final year of the forecast is calculated; the revision in this number between successive OBR forecasts is defined as the change in the PSND forecast. This is done in order to abstract from the impact of revisions to the debt stock and GDP level which are not reflective of either policy changes or an improvement/deterioration in the economic outlook). Similarly, the change in real earnings is defined as the revision between successive OBR forecasts for the change in the level of real earnings from the contemporaneous year of the forecast and the end of the forecast period. Earnings are defined in line with the OBR's definition: the national accounts measure of wages and salaries divided by the number of employees. These are put into real terms using the CPI.
SOURCE: RF analysis of OBR, Historical Forecasts Database; OBR, Economic and Fiscal Outlook, March 2022.

The tax share is set to rise to a 70-year high

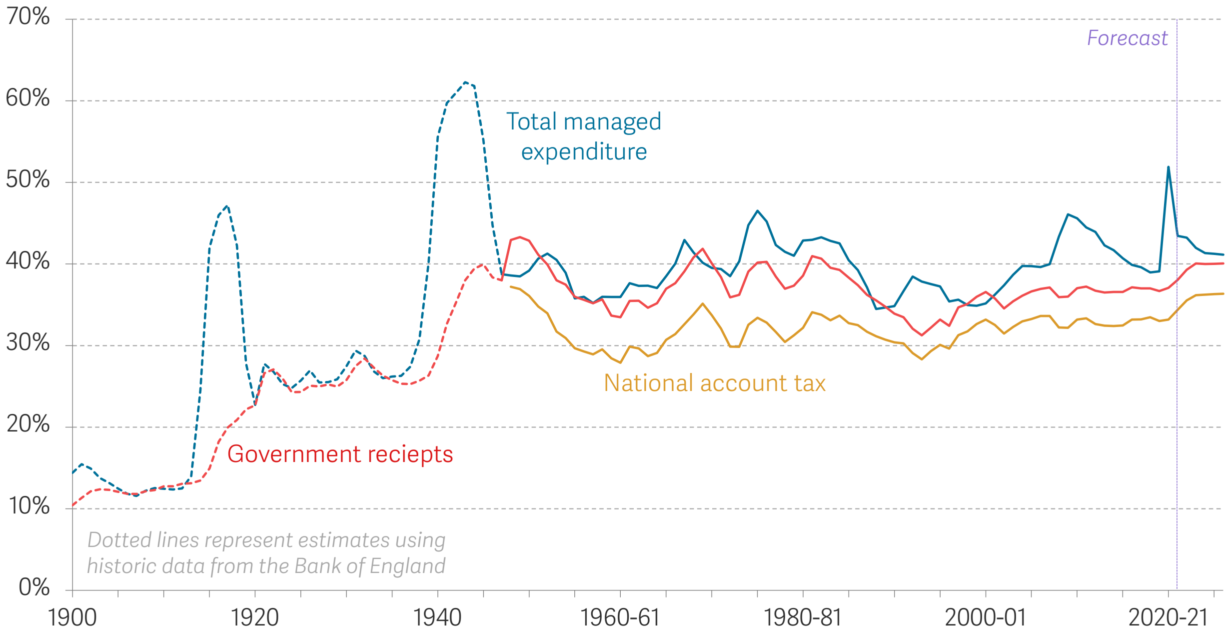
One of the key features of the improving fiscal outlook is the increase in tax revenues. The national accounts measure of taxes is now forecast to hit 36.3 per cent of GDP by 2026-27, the highest since the aftermath of the second world war (Figure 24). Similarly, public sector receipts, a broader measure of government revenue, is predicted to increase to 40.1 per cent of GDP by the end of the forecast. That equates to an increase in total government revenues per household of over £3,000 from the start of this Parliament. In fact, on current forecasts and after the cuts to Income Tax and NI, this Parliament will see the largest increase in taxes as a share of GDP of any parliament since 1950.[30]

30 It is important to note that these projections are based on current government policy, which includes Fuel Duty rising back to the level before the cut and then rising in line with RPI: this has been the policy for more than a decade, but every year the increase has been cancelled.

There is no single driver of the increase in tax revenues this year and over the forecast period.[31] Part of the story is a faster-than-expected recovery in taxes after the pandemic. For households, higher tax revenues reflect a combination of a faster-than-expected growth in total employee earnings, and frozen tax thresholds mean more people are paying basic and higher rate Income Tax. For the corporate sector, corporate profits (across both financial and non-financial firms) have risen, leading to greater Corporation Tax receipts.[32] The OBR now expects the economy to be more 'tax rich' over the forecast horizon; in other words, for a given level of aggregate economic activity, there has been an increase in tax revenue received by the Government. This means tax revenues are persistently higher across the forecast period even after taking account of the newly announced cut in the basic rate of Income Tax and the rise in NICs thresholds. The other part of the story of the rising tax share is the range of previously announced increases in taxes, notably the introduction of the Health and Social Care Levy and the upcoming rise in the rate of Corporation Tax.

FIGURE 24: **Despite policy changes, taxes revenues are expected to rise significantly in the coming years**

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



NOTES: Data prior to 1955 are for calendar years, rather than fiscal years.
SOURCE: RF analysis of Bank of England, A Millennium of Macroeconomic Data; OBR, Economic and Fiscal Outlook, March 2022.

31 We investigated this issue prior to the Spring Statement; see: A Corlett et al., Catch 2022: Spring Statement 2022 preview, Resolution Foundation, March 2022.

32 The OBR highlights that the rise in corporation tax receipts substantially exceeds what would be explained by the rise in corporate profits; see: OBR, Economic and Fiscal Outlook, March 2022.

The Government has set out broad details of a tax strategy, but current details suggest a limited impact

A welcome announcement in the Spring Statement was a plan to ensure that the tax system helps achieve the Government's broader economic objectives – faster growth and a higher level of productivity.

Much of the Plan discusses cuts in Fuel Duty, rises in National Insurance thresholds and (future) cuts to Income Tax rates. These all represent cuts to the rates of taxes announced by this Government (while skating over the reduction in the Income Tax personal allowance, and the rise in Corporation Tax) but, to a first approximation, they will have no impact on the shape of the economy in terms of employment and productivity: their primary effect is to increase some households' incomes at the expense of higher government borrowing.

But part of the plan comprises measures, and consultations on measures, designed to raise the growth rates of productivity and GDP. These are laudable and necessary aims. In the long run, productivity growth is the main determinant of wages and living standards. Labour productivity grew by only 0.4 per cent per year over 2007-19, one of the slowest rates among rich countries, and much slower than the approximately 2 per cent rate in the preceding 12 years.

The Employment Allowance (EA) allows eligible employers – i.e. those with total NI bills of less than £100,000 per year – to reduce their total NI liability in each year by the value of the allowance. The Spring Statement increased EA from £4,000 to £5,000 from April 2022 at a cost of around £400 million per year. In the long run, cuts to employers' NI is should lead to higher wages.[33] The effect of the EA, then, is to slightly skew employment towards small firms, for whom it makes labour slightly cheaper. But given that small firms are less productive than large ones, the extent that this measure affects the distribution of employment at all, it is likely to be in a way that reduces productivity.[34]

The measures listed under 'capital, people and ideas' are more promising, but much less-well defined at this stage. The Tax Plan is right to identify these both as key drivers of productivity and as places where the UK can do better, and recent work by Resolution Foundation supports much of the Treasury's analysis of the UK's productivity gap.[35] In particular, the UK invests in capital much less than its peers and, as the Chancellor noted in his speech, this is a key driver of its productivity gap with some obvious comparator countries, notably France. There is already some promising evidence that the Corporate

33 See, for example: P M Anderson and B D Meyer, The effects of the unemployment payroll tax on wages, employment, claims and denials, 2000, Journal of Public Economics (78) 81-106
34 See, for example: B Van Ark and E. Monnikhof, Size Distribution of Output and Employment: A Data Set For Manufacturing Industries in Five OECD Countries, 1960s-1990, 1996, OECD Economics Department Working Paper No. 166
35 See: J Oliveira-Cunha et al,, Business Time, 2021, Resolution Foundation

Tax changes announced in the March 2021 Budget have boosted investment among UK businesses, so it is welcome that the Treasury is planning to consult on how to prevent the forthcoming Corporate Tax increases from harming investment.[36] On worker skills, the Government has said that will look whether it can incentivise businesses to invest more, but gives no details at this stage. On 'ideas' – for which, read 'technology and research and development (R&D)' – there are some small changes in the scope of current R&D reliefs, and an announcement of further unspecified changes at the next Budget.

Overall, then, the Spring Statement raises an important issue in the form of the UK's poor growth performance and correctly identifies its main causes. However, the measures actually announced are very limited in scope, and we will have to wait until the reviews it launches report back before judging their full impact.

Conclusion

It is hard to overstate the scale of the cost of living crisis that's coming, with the highest inflation in 40 years and the worst income squeeze on record lying ahead of us. Against that backdrop, and with fiscal ammunition thanks to the OBR's borrowing forecasts improving by £42.4 billion over five years, the Spring Statement saw the Chancellor prioritise rebuilding his tax-cutting credentials over supporting the low-to-middle income households who will be hardest hit from the surging cost of living, but while also leaving himself fiscal flexibility in the years ahead. The package of measures announced offered some immediate support to households and also laid the ground for a 2024 election. But on both counts – not least with a decision on this winter's energy price cap due in less than six months – it looks likely to be far from the last word.

36 See: P Bunn et al., Influences on investment by UK businesses: evidence from the Decision Maker Panel, 2021, Bank of England Quarterly Bulletin 2021Q2

Resolution Foundation

The Resolution Foundation is an independent think-tank focused on improving living standards for those on low to middle incomes. We work across a wide range of economic and social policy areas, combining our core purpose with a commitment to analytical rigour. These twin pillars of rigour and purpose underpin everything we do and make us the leading UK authority on securing widely-shared economic growth.

The Foundation's established work programme focuses on incomes, inequality and poverty; jobs, skills and pay; housing; wealth and assets; tax and welfare; public spending and the shape of the state, and economic growth.

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