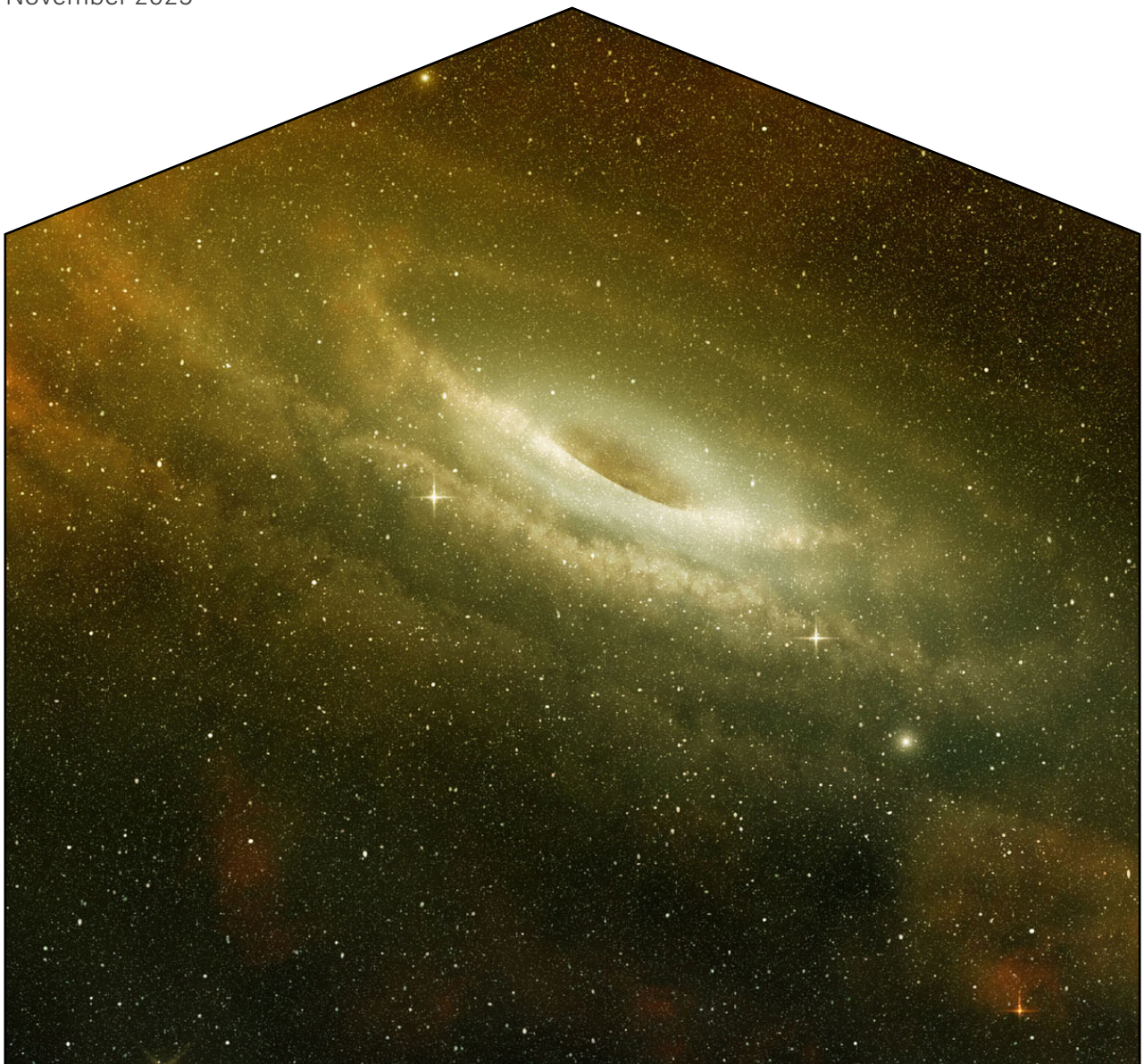


Black holes and consolidations

Previewing the key decisions for Budget 2025

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November 2025



Acknowledgements

We thank the Resolution Foundation's Macroeconomic Policy Unit Associates (Kate Barker, Wendy Carlin, Jason Furman, Toby Nangle, Jumana Saleheen, Silvana Tenreyro and Gertjan Vlieghe) for guidance and support. The authors have also benefited from conversations with colleagues at HM Treasury, the Office for Budget Responsibility, the Bank of England, the Office for National Statistics and the International Monetary Fund. Contributions and comments from colleagues at the Resolution Foundation are gratefully acknowledged, particularly Mike Brewer, Sophie Hale, Lindsay Judge, Charlie McCurdy and Gregory Thwaites. All views and errors remain those of the authors.

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C Aref-Adib, E Christensen, A Clegg, A Corlett, R Curtice, J Marshall, L Murphy & J Smith,
Black holes and consolidations: Previewing the key decisions for Budget 2025, Resolution
Foundation, November 2025

<https://doi.org/10.63492/yjk8073>

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Summary

The upcoming Budget is a make-or-break moment for the Government. After raising taxes and increasing spending significantly last autumn, Rachel Reeves declared that she would not be “back for more”. Yet it seems very clear that this month’s fiscal event will include significant spending cuts and tax rises spurred by a significant deterioration in the public finances. The challenge for the Chancellor, then, is how to improve the mood music around her economic policy agenda while also delivering a tightening in fiscal policy.

The big economic judgement for the Office for Budget Responsibility (OBR) at this Budget will be its revised view of the UK’s ‘trend’ productivity growth – effectively our economic ‘speed limit’ – where a downgrade is widely anticipated. It has been briefed that there will be a 0.3 percentage point downgrade, punching a £20 billion hole in the public finances by 2029-30. A change on this scale would be plausible: it would essentially bring the OBR into line with the Bank of England. And although this change has long been warranted, the timing is out of kilter with the data which, when you measure employment correctly, shows productivity growth at around 2 per cent, the highest sustained rate since the late-2000s financial crisis. It is also possible that the hit to the public finances may be smaller than many expect – more like £14 billion in 2029-30, the year that matters for the fiscal rules – because the impact of any downgrade is likely to be backloaded, only affecting the later years of the forecast. On the other hand, higher government borrowing costs and ‘u-turns’ on Winter Fuel Payments and disability benefit cuts are likely to add a further £12 billion to borrowing.

There is, however, a good chance that other changes to the economic outlook provide some relief for the Chancellor. Chief among these is wage growth. The OBR’s March 2025 forecast for pay increases was very weak, and a stronger outlook for pay could wipe out almost all the hit from lower trend productivity growth. Overall, our modelling suggests that, before any new policy announcements, changes in the economic outlook, as well as those u-turns, are likely to lead to a rise in borrowing of around £14 billion, more than wiping out the £10 billion of headroom against the Chancellor’s ‘current borrowing’ rule at the Spring Statement.

So, although there is much uncertainty about where the fiscal forecasts will ultimately land, these numbers point to a bleak picture for the public finances. Against a backdrop of volatility in the cost of government borrowing, this reinforces the need for the Chancellor not just to fill the fiscal hole, but to take steps to boost financial-market confidence. This means she should aim to double the level of headroom held against her fiscal rules to £20 billion, or, perhaps more realistically, increase it to £15 billion. This would send a clear message to markets that she is serious about fixing the public

finances, which in turn should reduce medium-term borrowing costs and make future fiscal events less fraught.

The Government shouldn't rule out the possibility of introducing new, targeted policy measures at the Budget. The priority should be to help households struggling with high prices and to support the Government's laudable targets for reducing poverty. Most obviously, there is no route to bringing down child poverty without scrapping the two-child limit on benefit support, at a cost of £3.5 billion. This should come alongside action on energy prices, which remain the epicentre of the cost of living crisis. The Government should reduce the bits of energy bills it can control directly, moving social and net zero levies on electricity bills into general taxation, costing £3.5 billion in 2029-30. This would cut typical energy bills by £160 a year, bringing down inflation by 0.3 percentage points, as well as reducing the relative price of electricity compared to gas, supporting the move to net zero.

Increasing headroom at the same time as introducing these measures leaves the Chancellor needing to find spending cuts and tax rises of £26-31 billion. To give a sense of the order of magnitude here, if this amount was raised entirely through increases in tax, it would be a similar order of magnitude to the tax rises unveiled by Gordon Brown in 2002 and Rishi Sunak in 2021, but below those in last year's Autumn Budget and announced by Norman Lamont in 1993.

The Chancellor has been clear that at least part of any consolidation at the Budget will come from lower spending. But the lesson from the Government's botched attempt to announce benefit cuts in time for the Spring Statement is that such reforms should not be rushed. That leaves lower departmental spending. Given that the Chancellor set department spending totals through to 2029-30 just four months ago in the Spending Review, the scope for cuts here is limited, but freezing departmental spending in real terms in 2029-30 – itself no mean feat – would yield £5 billion of savings.

This would leave the Chancellor needing to raise taxes by £21-26 billion. Any tax changes must, as far as possible, limit the damage to the economy, while reassuring markets that there is a plan if the public finances deteriorate further. They should also fit with the economic circumstances we find ourselves in by avoiding further exacerbating the UK's inflation problem (our price rises are already the fastest among G7 countries). Instead, the Chancellor should put the burden on those with higher living standards who currently face lower tax rates. This means protecting working people on lower earnings.

Delivering tax rises along these lines, and on the scale required, means prioritising sensible reforms. The best option for reliably raising such sums by 2029-30 is to raise Income Tax (raising VAT, the other broad-based tax, would push up inflation). A 2p

rise across all three rates would raise around £20 billion. However, with wage growth weakening and unemployment rising, the Foundation recommends offsetting this tax rise with a 2p cut in employee National Insurance. That would raise £6 billion overall while protecting most workers from this tax rise. Other measures are almost certainly going to include some form of extension to the freeze in personal tax thresholds, potentially raising £7.5 billion if done for two years. Beyond that, measures should prioritise pro-growth reforms of the tax system, including by improving wealth, motoring and property taxes, and reducing the differences between how we tax employee earnings and other forms of income.

So, although tax rises are inevitable, there is a way to do them which comes with a boost confidence in the economy and the public finances, while also reducing child poverty and the cost of living.

The Budget is a pivotal event for this Government

The Budget on 26 November is a make-or-break moment for this Government. Its first Budget delivered an ambitious policy loosening, cancelling previously planned cuts to spending, paying for only some of that with higher taxes. But the reaction to that event was dominated by criticism of the large rises in National Insurance, levied on businesses, meaning a Budget of net giveaways was widely viewed as an economic headwind. Having promised not to be “back for more”, the Chancellor has already made the shape of this Budget very clear: a deterioration in the outlook for the public finances will be met by spending cuts and tax rises.¹ Chief among the headwinds is likely to be a judgement from the Office for Budget Responsibility (OBR) that will reduce its forecasts for medium-term growth. The challenge for the Chancellor, then, with the economy far from rosy and the Government deeply unpopular, is to improve the mood music around her economic policy agenda. In this briefing note we set out how the outlook has changed since March, focusing on the economy and the public finances, before turning to what the Government should do in response at this pivotal fiscal event.

The OBR is set to cut its assumed ‘speed limit’ for the economy

Changes to the Budget economic outlook are likely to be framed by the OBR’s decision on ‘trend’ productivity growth.² This is the rate at which UK workers become more efficient each year, so that the economy can produce more goods and services – and thus generate more tax revenues for the Treasury – without firms having to put their prices up. Marking this ‘speed limit’ down, as the OBR is widely expected to do, leads to lower forecasts for GDP growth and, hence, less extra tax each year into the future.

In its March forecast, the OBR had already assumed that productivity growth would take a while to pick up to this ‘speed limit’. That’s because the potential level of productivity – the rate at which firms are using their capacity to produce at normal rates – can be buffeted around by shocks, meaning that the growth rate of potential output can take a while to get back to the normal speed limit. For example, back in March the OBR assumed that productivity growth would reach its (assumed) trend rate of around 1.25 per cent a year only by 2029, with actual productivity growth over the forecast period being just 1 per cent.

However, although an assumed trend growth rate of 1.25 per cent a year is bleak compared to rates typical in the US today, or in the UK before 2008, it is conspicuously

¹ In a speech to the Confederation of British Industry’s Annual Conference in November 2024, the Chancellor said: “we have drawn a line under the inheritance I faced [from the Conservative Government] and we’re never going to have to do a Budget like that again...Public finances are now on a firm footing and public services are funded in a proper way...We’re not going to have to come back for more.”

² ‘Trend’ here is used to mean the OBR’s assumed sustainable rate of growth, or growth in the supply side potential of the economy, once short-term shocks have dissipated.

higher than that assumed by other forecasters. For example, the Bank of England assumes trend productivity growth of just 1 per cent in the long run. Back in March, the OBR's assumed trend was roughly the average of the pre-financial crisis decade (when productivity growth averaged a heady 2.2 per cent) and the decade after (a disappointing 0.5 per cent).³ If there is a markdown, then we can see this as the OBR giving up on a return to anything like pre-financial-crisis averages and putting more weight on recent outturns.

The timing of this change, though, is curious, given recent strong productivity growth.⁴ Although the official data shows very weak productivity growth, our view is that recent employment growth has been overstated by the Labour Force Survey (LFS); when that is corrected for, output per hour has been growing by around 2 per cent, a level not sustained since the financial crisis.⁵ Nonetheless, a markdown is justified based on the data over the past few years. The OBR last shifted its view of the trend in November 2017, when it wiped 0.7 percentage points off the assumed rate. But, since the pandemic, observed hourly productivity growth has been disappointing, averaging just 0.1 per cent a year.

In fact, the OBR has two decisions to make on its markdown. First: what level does it think the medium-term economic speed limit is? Second: how long will the economy take to reach this new speed limit (because it is only then that the new limit starts to affect the forecast)? Figure 1 shows our best guess of how it will mark down its assumed trend, where we think the OBR will reduce its view of trend productivity growth to around 1 per cent in 2029, at a stroke erasing around a quarter of a percentage point from forecast growth in that year.⁶ But the forecast growth rate of potential productivity is already weak in the near term, so we don't expect the impact of any weaker trend growth to bite until the later years of the forecast. Because of this, a downgrade to 1 per cent trend productivity growth would leave the growth rate of potential productivity 0.15 percentage points weaker across the forecast, but with that downgrade largely concentrated in 2028 and 2029.

³ We have defined the pre-crisis decade from Q2 1997 to Q2 2007 and the post-crisis decade as Q2 2010 to Q4 2019.

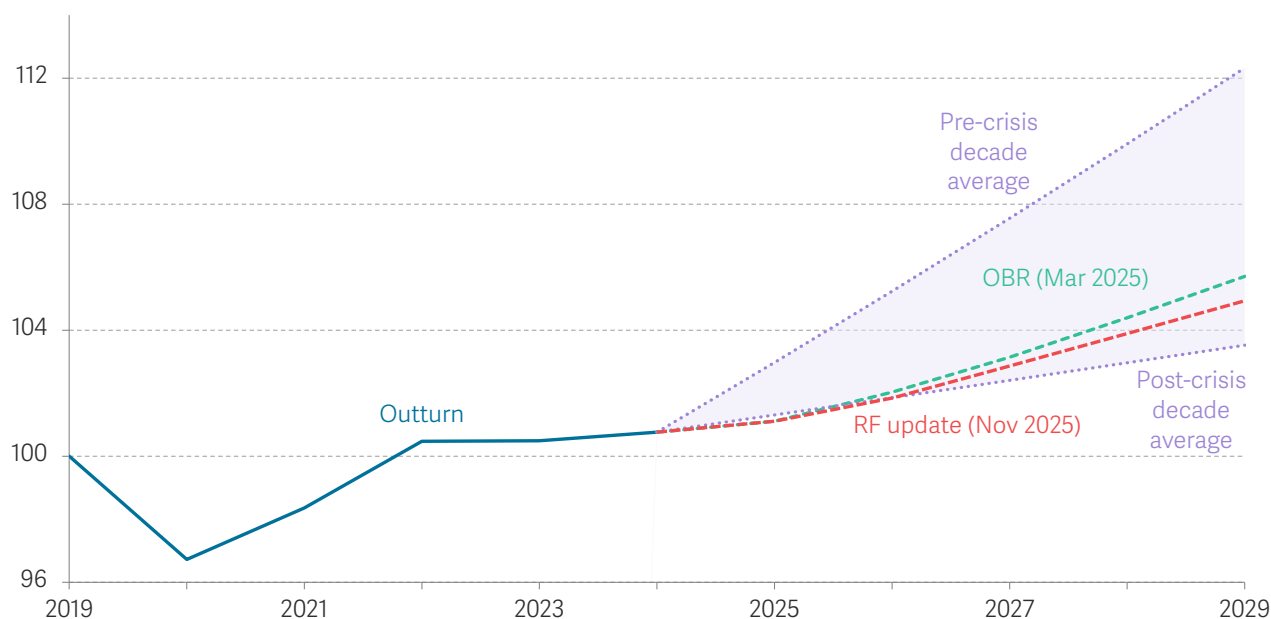
⁴ E Christensen & G Thwaites, [Trend setters: What is the OBR's forecast for trend productivity growth, and why it matters so much for the Budget](#), Resolution Foundation, October 2025.

⁵ A Corlett, [Get Britain's stats working: Exploring alternatives to Labour Force Survey estimates](#), Resolution Foundation, November 2024. <https://doi.org/10.63492/ezh349>

⁶ A 0.26 percentage point downgrade in the final year would be consistent with recent reports that the OBR is considering a reduction of "about 0.3 percentage points" from its forecast. See: [Reeves faces £20bn hit to UK public finances from productivity downgrade](#), Financial Times, 27 October 2025.

FIGURE 1: The OBR is set to markdown its assumed 'speed limit' for the economy

Potential productivity levels (output per hour worked, index 2019=100): UK



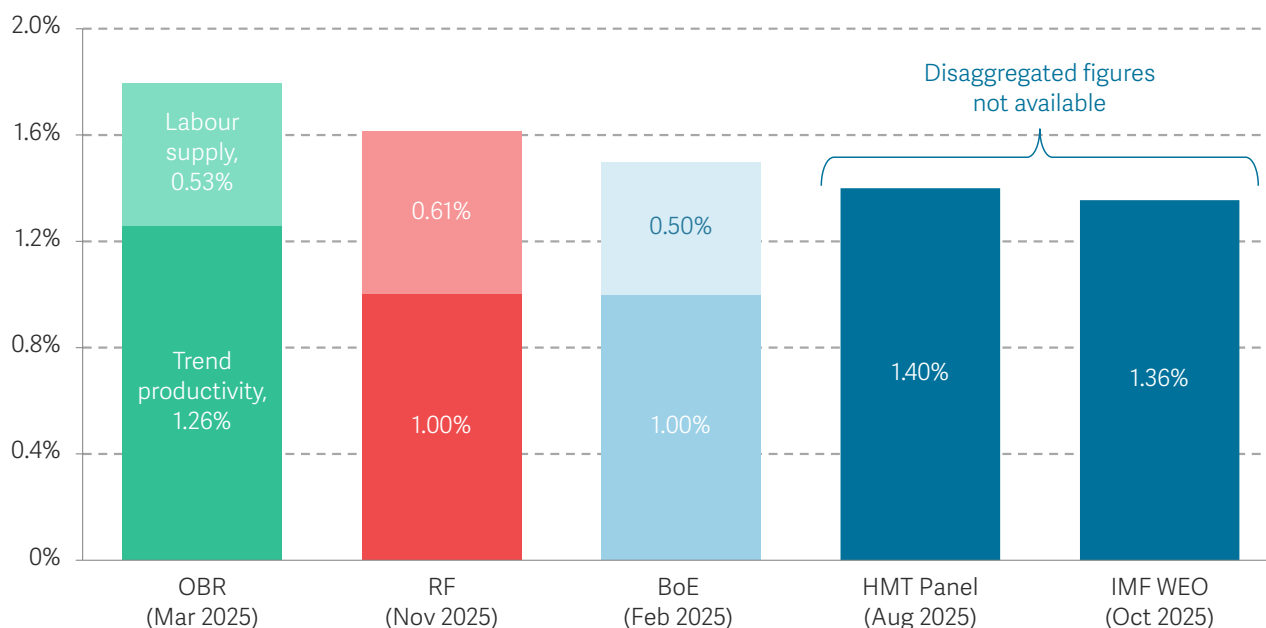
NOTES: The pre-crisis decade is defined as from Q2 1997 to Q2 2007 and the post-crisis decade as Q2 2010 to Q4 2019.

SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, March 2025.

Figure 2 sets out in detail how such a downgrade would bring the OBR's projections more in line with those of other forecasters, including the Bank of England. In the final year of its March 2025 forecast, the OBR forecast that trend (and actual) GDP growth would be 1.8 per cent: 1.3 per cent productivity growth plus a contribution of 0.5 percentage points from a combination of a larger labour force (+0.7 percentage points) working fewer average hours (-0.2 per cent). This total of 1.8 per cent was 0.4 percentage points higher than the average of medium-term forecasts compiled by the Treasury (these forecasts are for actual GDP growth, rather than trend, but the two should be very similar in 2029). Our best guess of what the OBR will publish later this month is shown in the red bar. A forecast of 1.6 per cent growth – with 1 percentage point coming from trend productivity growth and the rest coming from labour supply – would still be above the Bank of England, the IMF and the average of other forecasters, but much less so than before.

FIGURE 2: A downgrade to trend productivity would bring the OBR more in line with other forecasters

Forecasts for medium-term potential supply growth (and contributions from underlying components where available): UK



NOTES: Forecasts for potential supply growth in 2029 with the exception of the Bank of England, which is for 2027, the final year of its forecast. The HMT Panel uses the medium-term average forecast of real GDP: we assume the majority of forecasters' change in output gaps are equal to or near zero.

SOURCE: RF analysis of OBR, Economic and fiscal outlook, March 2025; ONS, National Accounts; Bank of England Monetary Policy Report – February 2025; HMT Forecasts for the UK economy, August 2025; and IMF World Economic Outlook data, October 2025.

BOX 1: It's plausible that growth policies announced since March could have a positive impact on the OBR's forecast

Since the Spring Statement, the Government has announced a range of policies to help boost growth. These include reforming the planning system for infrastructure projects; pension sector reform; employment rights legislation; welfare reforms; skills and training programmes; progressing the creation and capitalisation of Great British Energy/Great British Energy – Nuclear; a UK-EU 'reset'; and concluding

a free trade agreement with India and a bespoke trade deal with the US.

We can be confident that at least some of these policies will generate faster growth. For example, the planning system is widely cited as a major constraint upon the UK's economic growth.⁷ The Planning and Infrastructure Bill was introduced in March 2025 to accelerate residential development and major infrastructure

⁷ D Lawrence et al., *Results from the UK Growth Survey 2025*, Centre for British Progress, October 2025.

projects, including electricity grid investment. The OBR has already said the Bill may support delivery of the Government's changes to the National Planning Policy Framework (NPPF), which they scored in their March 2025 forecast, and may also judge the reforms are sufficient to boost investment in major infrastructure projects. Similarly, the Government is reforming the UK pensions sector, via the Pension Schemes Bill, in the hope of achieving economies of scale and higher levels of investment in UK assets. The OBR has yet to score the economic effects of the proposals.

But such improvements to the supply side of the economy will take time to have an impact. Greater levels of investment will also generate additional aggregate demand but the lasting effect on productivity will come through more slowly as new infrastructure gets up and running. Indeed, the OBR currently assumes public investment takes around 10 years to be completed, during which time the effect on potential output is only partial.⁸

The Government must also reckon with trade-offs across its policy agenda. The Employment Rights Bill received its first reading in October 2024, but the OBR has yet to score its impact, citing uncertainty surrounding the

final policy, which will be clarified in secondary legislation. Nevertheless, it has noted that its forthcoming forecast will include its central estimate of the proposed legislation and signalled that it considers the effect of the Bill will likely, on balance, have "net negative, economic impacts on employment, prices and productivity."⁹ This is not to say the Government should abandon the reforms. Our own assessment suggests the reforms may only have a small economic impact – 0.02 percentage points to employment – and the Government may legitimately pursue objectives besides growth.¹⁰

Despite some positive effects from policy, it is likely that we still end up with lower trend productivity growth. Indeed, the route to the OBR's new assumption here could well be a bigger downgrade than discussed above, combined with scoring of some of these policies. For this note, however, we present our assumptions as net of OBR judgements on the growth benefits of specific policies. If the OBR's new assumption for trend productivity growth is 1 per cent this is still much higher than the post-pandemic average, so delivering such growth could require significant policy measures. The Government may find that all its growth policy means, like Alice, is running as fast as it can, just to stay in place.

⁸ Office for Budget Responsibility, *Discussion Paper No.5: Public investment and potential output*, August 2024.

⁹ Office for Budget Responsibility, *Policy risks database – March 2025*, published May 2025.

¹⁰ See: N Cominetti & C McCurdy, *Low Pay Britain 2025: Where next for the Government's employment reforms?* Resolution Foundation, July 2025, <https://doi.org/10.63492/bjv537>, and: N Cominetti, *Unfair Dismissal – Day One Frights*, Resolution Foundation, October 2025, <https://doi.org/10.63492/aqrn3850>

The impact of a very large markdown to medium term growth on the public finances may not be quite as bad as some had feared, however, at least in terms of fiscal rules that bind in the fourth year of this forecast. This is mainly because, as mentioned above, we expect that the bleaker OBR assumption for trend productivity growth will only kick in during the later years of the forecast. Based on our best guess of how the OBR will change its assumed trend, the economy would be 0.7 percentage points (£25 billion in nominal terms) smaller than previously forecast in four years' time.¹¹ This would erode the public finances by around £14 billion, primarily through lower tax receipts. This would still be enough on its own to wipe out the Chancellor's thin headroom against her fiscal rule to balance the current budget, of £9.9 billion in 2029-30.

While growth starts the forecast stronger than expected, the outlook has deteriorated beyond that

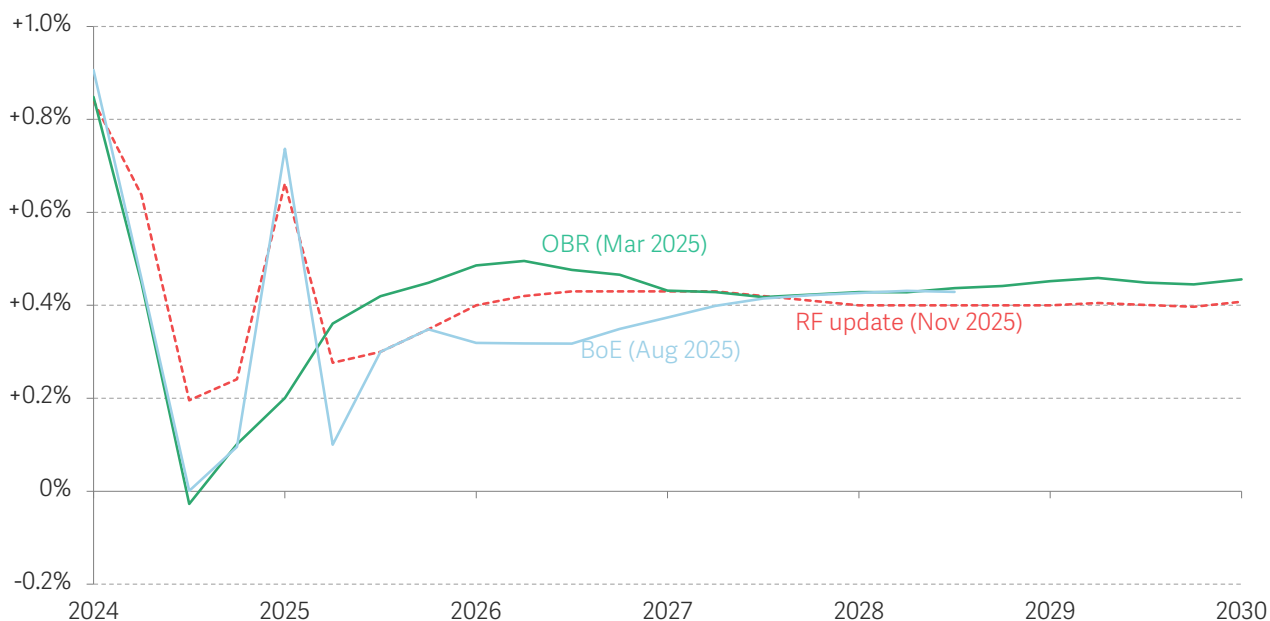
The path of trend productivity growth determines how much extra the economy can produce, and generate in tax, each year in the medium run. But in the short run, the path of demand and supply can be buffeted by shocks. There has been some good news on this front since the most recent OBR forecast in March. The economy grew by 0.9 per cent in the first half of this year, compared with the second half of 2024, making it the fastest growing economy in the G7, much stronger than the 0.4 per cent pencilled in by the OBR.

But, unfortunately, the good news on growth ends there. If the OBR marks down trend productivity growth as expected, that would imply a similar change to the outlook for overall growth in the medium term. On top of that, the near-term outlook has deteriorated given a rise in trade uncertainty emanating from the US following new tariffs put in place by President Trump. While other countries have by and large not retaliated, reducing the size of the headwind to global growth, it is likely that the OBR will reduce growth in 2025 and 2026 (albeit with something of bounce back thereafter). Combined, as shown in Figure 3, the OBR's forecast is likely to be weaker in the near term than it was in March, as well as towards the end of the forecast when the effect of the assumed markdown to trend growth dominates.

¹¹ Using the OBR's ready-reckoner model, OBR, [March 2025 Economic and fiscal outlook – ready reckoner](#), September 2025.

FIGURE 3: GDP growth is likely to be significantly weaker than in the OBR's March forecast

Quarterly growth in real GDP, chained-volume measure, outturn Bank of England and OBR forecasts: UK

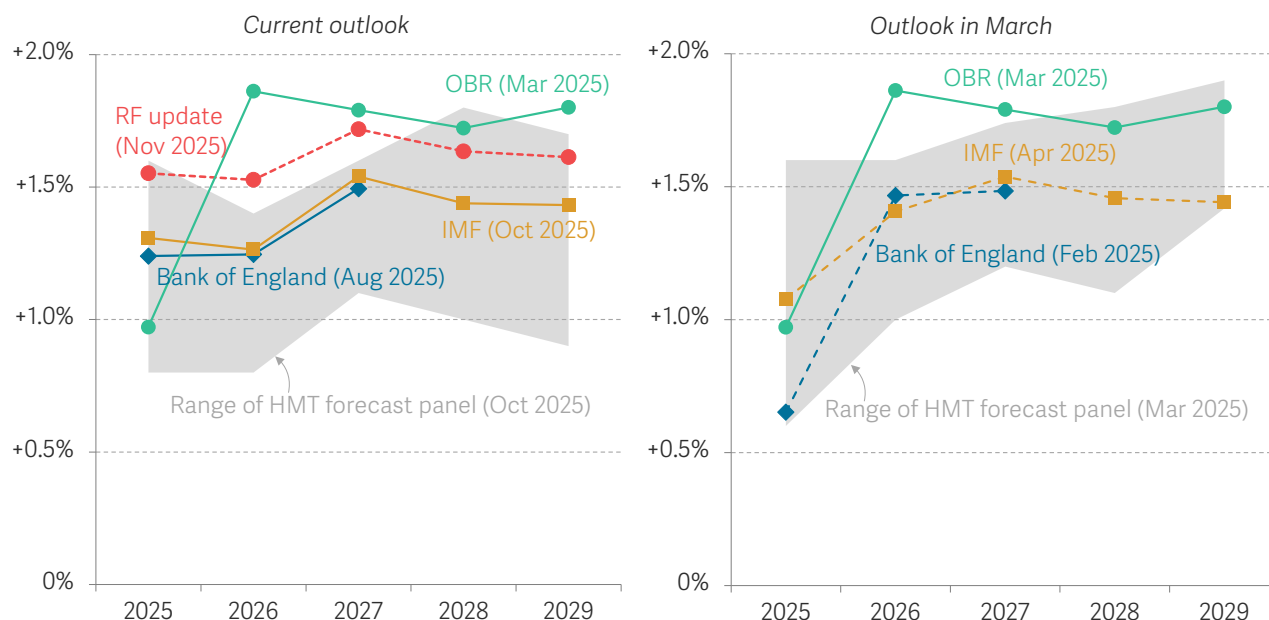


SOURCE: RF analysis of ONS, National Accounts; Bank of England, Monetary Policy Report, various; OBR, Economic and Fiscal Outlook, various.

All this would leave the OBR marking up calendar-year GDP growth for this year, but down for later years. It's likely that growth for 2025 will be stronger than in March, reflecting both that stronger recent performance but also upward revisions to the recent back data as shown in Figure 4. In our RF update scenario, growth is 1.6 per cent in this year, much stronger than the OBR forecast of 1.0 per cent. Beyond this year, however, we expect the OBR to forecast lower growth, bringing it more into line with other forecasters.

FIGURE 4: A markdown from the OBR will bring it more into line with other forecasters

Forecasts for annual real GDP growth, current outlook (right-hand panel) and outlook in March (left-hand panel): UK



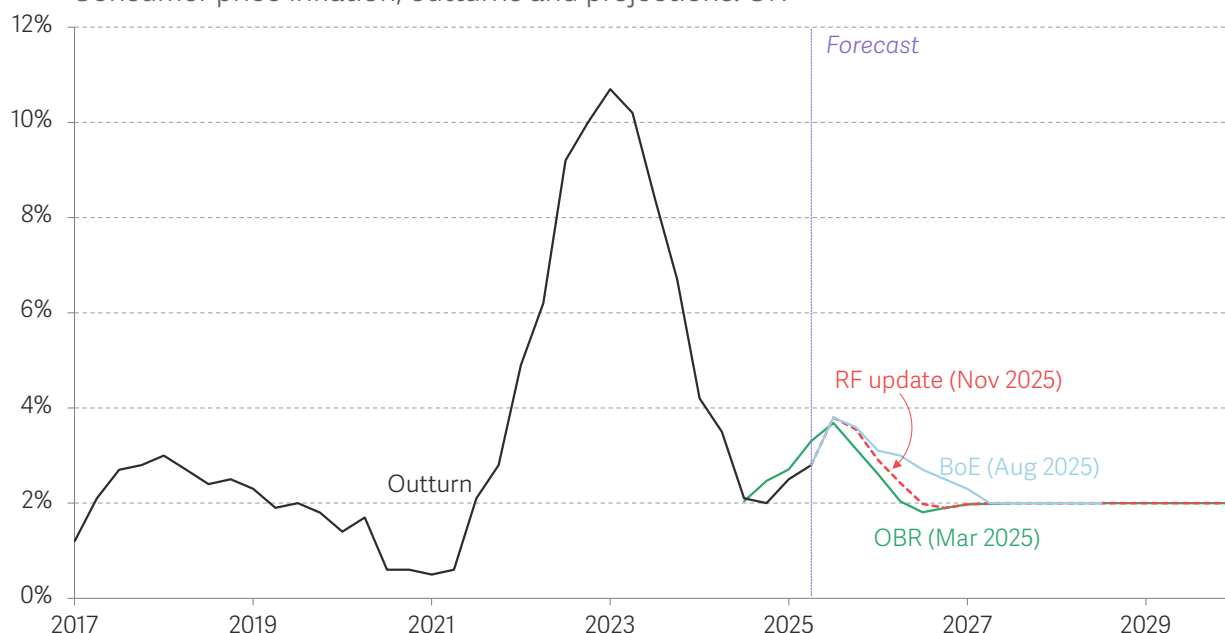
NOTES: The swathe shown in the left panel shows only includes forecasts made since January.

SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, various; HM Treasury, Forecasts for the UK Economy, various; Bank of England, Monetary Policy Report, various; and IMF, World Economic Outlook, various.

Looking beyond the outlook for GDP growth, it's likely that the OBR will have a slightly higher profile for inflation. CPI inflation has reaccelerated in recent months, driven by the effects of increases in administered prices such as water, rail fares and energy, but also reflecting the impact of higher employer National Insurance contributions following changes made at the Autumn Budget last year. With the benefit of hindsight, the OBR did a good job at the Spring Statement of forecasting this rise in inflation, pencilling in inflation of 3.7 per cent in Q3 2025, only slightly below the outturn of 3.8 per cent. Looking ahead, we expect inflation will be a little higher in the near term than expected by the OBR in March, reflecting signs of stickiness in domestically generated inflation, but to fall back more quickly than in the Bank of England's forecast.

FIGURE 5: Inflation is likely to be higher in the short term than the OBR expected in March

Consumer price inflation, outturns and projections: UK



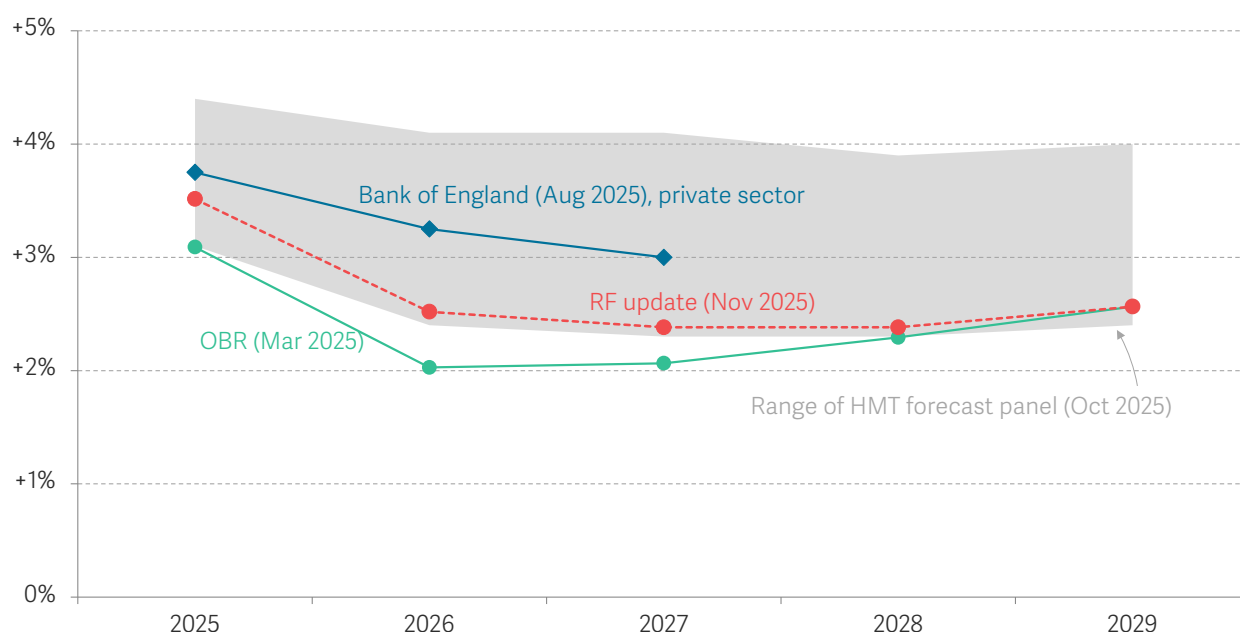
SOURCE: ONS, Consumer Price Inflation; OBR, Economic and fiscal outlook, various; and Bank of England, Monetary Policy Report, various.

Good news for the Government could come in the form of a faster wage growth forecast

Another key judgement for the OBR is on its forecast for wages. With Income Tax and National Insurance expected to bring in more than half a trillion pounds this year, small changes in the forecast for wages can matter a lot to the public finances. And while wage growth has been easing in recent months (falling from over 6 per cent at the end of last year to around 4.4 per cent in August on a whole-economy basis), it has been higher than expected back in March. In this context, the OBR's Spring Statement forecast looks very weak, with wage growth falling back to 2 per cent by the end of next year, implying sharp falls in the share of national income going to workers. So, despite a bleaker outlook for productivity, which will reduce the amount firms can afford to pay their workers without suffering a fall in profitability, we expect the OBR to judge that its March forecast for wage growth was implausibly weak (Figure 6), and so raise it. Even if the OBR does so, there remains considerable uncertainty about the extent of any forecast changes. But the changes we have assumed leave wage growth much closer to other forecasters, including the Bank of England, and is consistent with a smaller fall in the labour share than in the OBR's March forecast.

FIGURE 6: Wage growth was extremely weak in March and could well be revised up despite the worse outlook for productivity

Forecasts for average earnings growth: UK



NOTES: For OBR and HMT panel forecasts are for growth in Q4 of the year shown compared with Q4 the previous year; for the Bank of England, it is calendar year average growth rounded to the nearest quarter of a percentage point and covering private-sector regular pay. Swathe includes only forecasts made since January.

SOURCE: Bank of England, Monetary Policy Report, August 2025; OBR, Economic and Fiscal Outlook, various; and ONS, Labour Market Statistics.

There also appears to be some bad news in the recent public finances data

Data on the public finances show borrowing is a little higher than expected six months into the 2025-26 financial year. Public sector borrowing was £99.8 billion in the six months to September, £7.2 billion above the OBR forecast, although just £1.5 billion of this reflects weaker central-government data. And overall, receipts were close to the OBR forecast. That said, improved economic data in the first half of this year mean that we would have expected receipts to be above forecast. Accounting for this, we would have expected receipts to be roughly 0.5 per cent stronger than outturns, based on estimates from the OBR's simple model for receipts and spending.¹² We judge that around half this weakness in the public finances data is likely to persist.

Higher debt interest costs are also likely to worsen the public finances. Here, as we have discussed in recent work, the cost of borrowing for the Government has been volatile in recent months.¹³ We estimate our update using a guess of the ten-day window that the

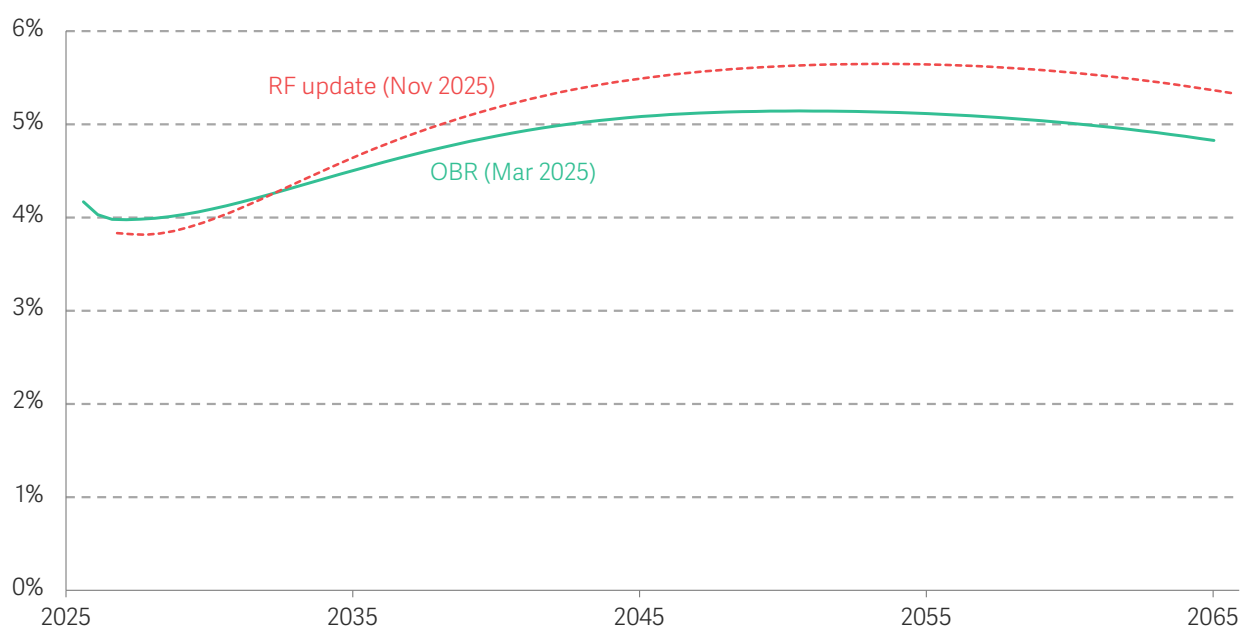
¹² OBR, *March 2025 Economic and fiscal outlook – ready reckoner*, September 2025.

¹³ J Smith, *The Macroeconomic Policy Outlook: Q3 2025*, Resolution Foundation, 12 September 2025. <https://doi.org/10.63492/rxn9076>

OBR will use for taking market values based on their practice in recent forecasts.¹⁴ Higher yields mean higher debt interest and, ultimately, higher borrowing. Yields are around half a percentage point higher at longer horizons (30 years and beyond), but roughly half that at shorter horizons (out to 20 years) that are more relevant for borrowing. . Expectations for Bank of England policy rates also matter for debt interest as it affects the cost of the Bank of England holding gilts as part of its quantitative easing portfolio (which is effectively financed at the policy rate). Those rates are little changed relative to March. But there has been a significant change here with the Bank of England slowing the pace of its asset sales from around £100 billion a year in recent years to around £70 billion in 2025-26. We assume this slower pace of sales continues over the forecast period, meaning that the Bank is holding far more gilts by the end of the forecast period. These gilts were acquired at lower yields than the future level of Bank rate at which they will be financed. So holding more of them adds around £3 billion to borrowing, meaning that debt interest is adding nearly £6 billion to borrowing by 2029-30.

FIGURE 7: The cost of borrowing has risen for the Government since March

Government borrowing costs (gilt spot curve): UK



NOTES: March 2025 yield curve is based on the average of yields in the 10 working days to 12 February 2025. For the RF update, the 10 working days to 15 October 2025 is used.
SOURCE: Bank of England, Yield Curves.

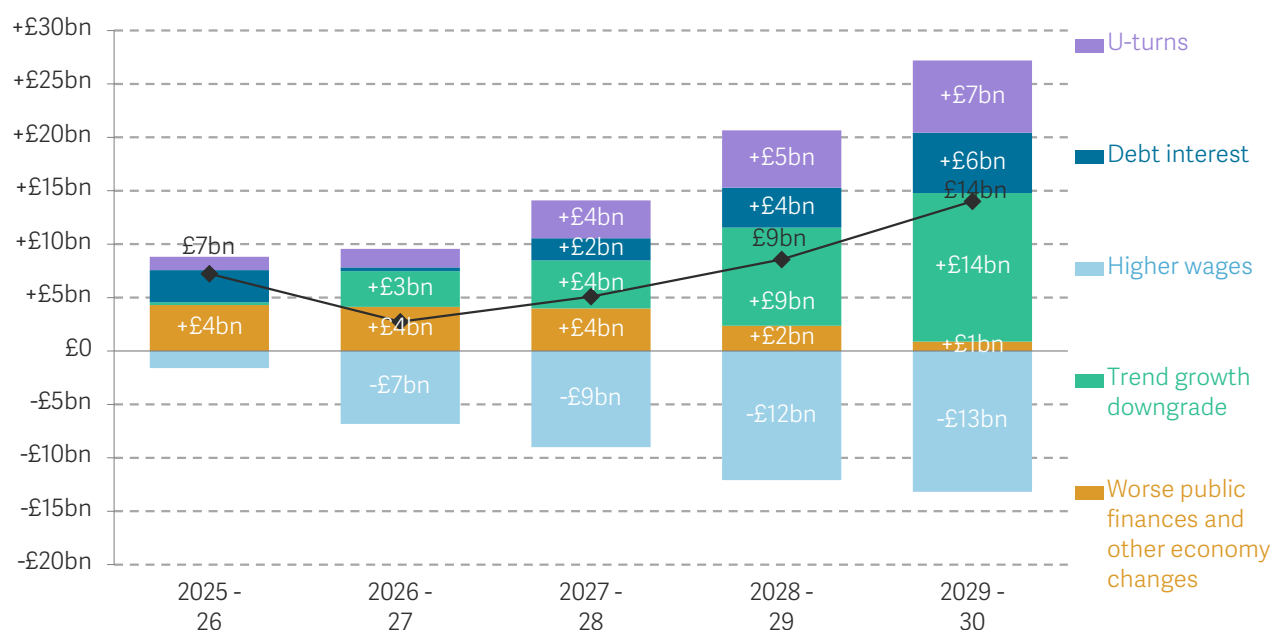
¹⁴ Specifically, we use the 10 working days to 15 October. Yields have subsequently fallen and on a single-day basis and are now below the levels underlying the March forecast but our estimate of the 10-day average is higher than at the time of the data cut off for the Spring Statement, as shown in Figure 7. Higher debt interest costs are likely to worsen the public finances, and this is true for any window the OBR could plausibly choose ahead of the third round of its forecasts.

All this leaves the public finances much weaker than at the time of the Spring Statement

Adding all this up, the outlook for the public finances is significantly weaker than at the time of the OBR March forecast. Figure 8 shows the impact of the economic and fiscal changes discussed so far on borrowing, where positive numbers in this chart indicate higher borrowing. The impact of the two big judgements from the OBR stand out clearly. In green is the £14 billion hit from lower trend productivity growth. While smaller than the £20 billion expected by some, reflecting the likely backloading of this judgement, this is still a very large hit to the public finances. Set against that, though, the impact of faster growth in wages in light blue is only slightly smaller, reducing borrowing by around £13 billion. Debt interest, given higher gilt yields and a slowing in Bank of England gilts sales, also pushes up on borrowing by £6 billion in 2029-30. There are also some smaller changes to the forecast in orange reflecting the deterioration in the public finances, partially offset by the effect of somewhat higher inflation. Finally, Government u-turns on Winter Fuel Payments (WFP) and disability benefits are included on this chart, amounting to around £7 billion of extra borrowing by 2029-30. Overall, then, borrowing is around £14 billion higher than forecast in March by 2029-30.

FIGURE 8: Borrowing would be £14 billion higher in 2029-30 as a result of u-turns and changes in the economy forecast

Impact of possible changes to the OBR forecast on public sector net borrowing: UK



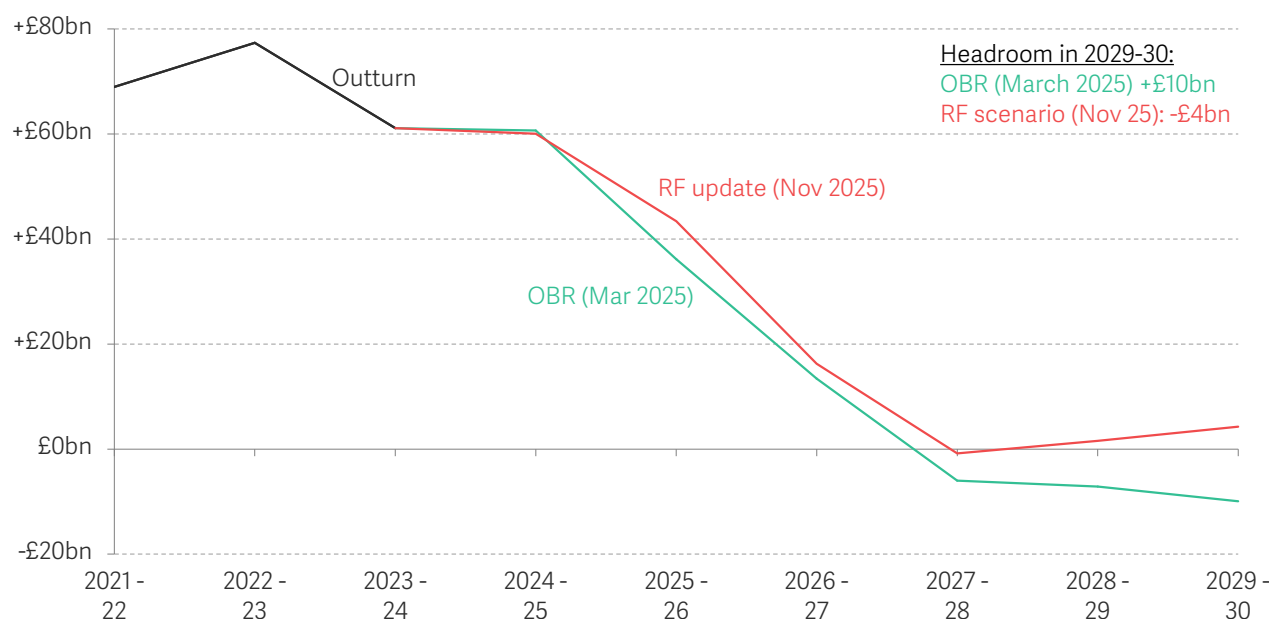
SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, March 2025.

Figure 9 shows the deterioration to the current deficit. A positive number here indicates the Government borrowing to cover day-to-day spending. Based on our modelling, there

would be a current-balance deficit (i.e. borrowing to fund day-to-day spending) of around £4 billion in 2029-30, the year at which the fiscal rules will be evaluated, as a result of u-turns and changes to the economic outlook.

FIGURE 9: Headroom is more than wiped out based on expected forecast changes

Public sector current budget deficit: UK



SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, March 2025.

Despite a big hit to the public finances there is some scope for spending money at the Budget and the priority should be living standards

Although it looks like we heading for a big deterioration in the public finances, the Chancellor will also have to think about where to provide some good news. The focus here should be supporting living standards and helping families struggling with the cost of living. The price of food and energy have risen by 38 and 55 per cent respectively between July 2021 and September 2025, much more than the 25 per cent rise in the overall price level. This rise in the cost of essentials has led to a significant increase in hardship, with many more families now using foodbanks and a huge rise in arrears on energy bills. To be clear, providing support will not be easy: every extra pound spent means greater savings will have to be found elsewhere. So, below we discuss some of the areas in which the Government should prioritise its limited policy space.

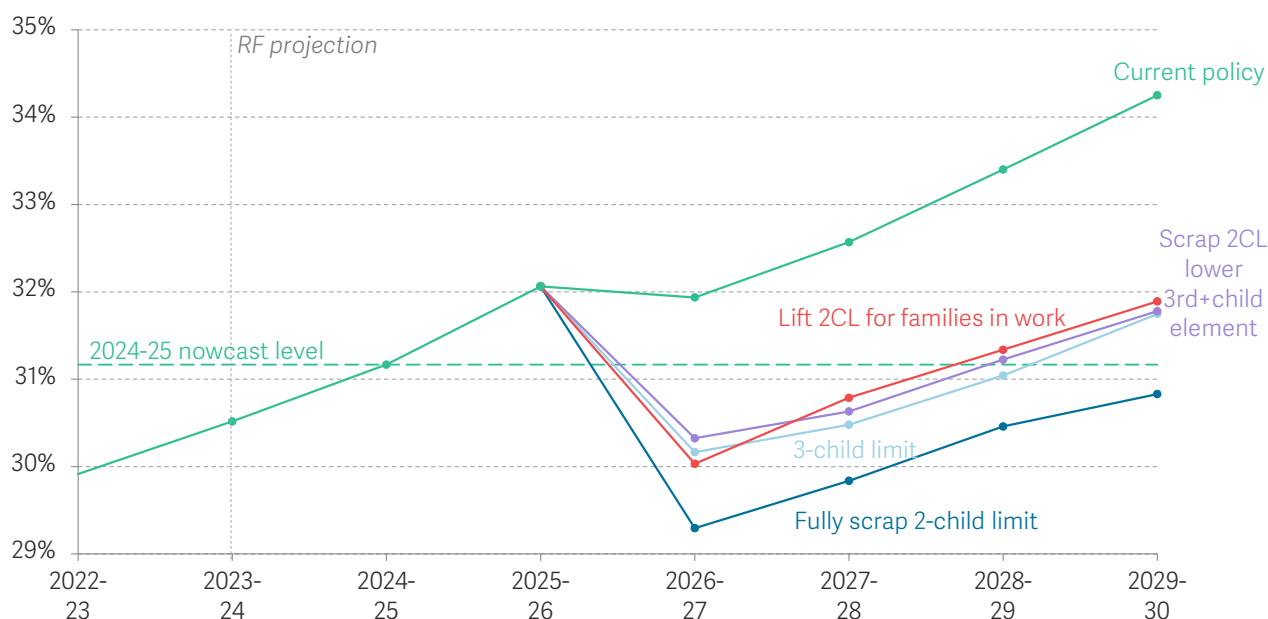
With money tight, the Government must take the most cost-effective action it can to support living standards

The Government has (rightly) committed to putting child poverty on a downward trajectory over the course of this Parliament. With that in mind, the Child Poverty Strategy is expected to be published around the time of the Budget. As we have shown in previous work, a credible strategy must tackle the two-child limit.¹⁵ Scrapping the two-child limit in full would mean 480,000 fewer children growing up in poverty in 2029-30 compared to our projection based on current policy, a crucial step if the Government is serious about reducing child poverty. This would cost £3.5 billion in 2029-30, and although it would be the most cost-effective option (at a cost of £7,280 per child lifted out of poverty), the price tag is clearly significant. It is unsurprising, then, that it is rumoured the Government has been exploring options for partial reform of the two-child limit, most notably lifting the limit for working families only; moving to a three-child limit which would restore benefit entitlement for third children, but not for any fourth or subsequent child; and scrapping the limit in full, but then paying the UC child element at a reduced rate for third and subsequent children. Each of these options would cost around £1 billion less in 2029-30 compared to fully scrapping the policy. But, crucially, as Figure 10 shows, all of these partial-repeal alternatives would leave child poverty rates higher at the end of the forecast period than at the beginning (just under 32 per cent compared to just under 31 per cent in 2024-25), an outcome that is inconsistent with the Government's promise to be ambitious with respect to reducing child poverty.

¹⁵ A Clegg & L Judge, *No half measures: Setting child poverty on a downward course at the Autumn Budget*, 30 October 2025. <https://doi.org/10.63492/lmc139>

FIGURE 10: Child poverty will be higher in 2029-30 than 2024-25 if the Government does not fully scrap the two-child limit

Proportion of children living in relative poverty, after housing costs: UK



NOTES: All values beyond 2023-24 are projections. Modelled policy changes occur in April 2026. 'Lower 3rd+ child element' introduces a child element at two-thirds the value of the standard child element for third and subsequent children. Does not include the Scottish Government's intention to mitigate the two-child limit from April 2026. 'Lift 2-child limit for families in work' means families are exempt from the policy if they earn more than the equivalent of 16 hours per week at the National Living Wage. SOURCE: RF analysis of DWP, Households Below Average Income; RF projections including use of the IPPR Tax Benefit Model; DWP, Family Resources Survey; ONS, various; Bank of England, Monetary Policy Report, August 2025; and OBR, Economic and Fiscal Outlook, March 2025.

The Budget can deliver help for families struggling with the cost of living, and electricity costs are the right place to act

The cost of living crisis has eased but is far from over. Inflation remains stubbornly close to double the Bank of England's 2 per cent target, the highest rate in the G7, with inflation for essentials such as energy and food remaining well above the headline figure. This is particularly hard for lower-income families who spend much more on these essentials.¹⁶ So it's encouraging that the Chancellor has said that she is planning 'targeted action' to help families at the Budget.¹⁷ The priority in this context should be electricity costs, with energy bills still the epicentre of the on-going squeeze on households. Energy costs remain substantially above their levels before Russia's invasion of Ukraine: average bills are up around £600 in cash terms, or 25 per cent in real terms.¹⁸ They are also top of mind for voters who repeatedly cite the cost of living as their top concern.¹⁹

¹⁶ Source: ONS, *Consumer price inflation, September 2025*. For a discussion of the impact of the high cost of essentials on lower-income families, see: S Pittaway & L Try, *The bare necessities*, Resolution Foundation, June 2025. <https://doi.org/10.63492/twg315>

¹⁷ See: F Islam, *Reeves plans 'targeted action' on bills in Budget*, BBC News, October 2025.

¹⁸ J Marshall, *Splitting the bill*, Resolution Foundation, October 2025. <https://doi.org/10.63492/hpc653>

¹⁹ Polling in August 2025 found that 66 per cent of British households identified gas and electricity bills as 'causing the most concern about the cost of living at the moment'. Source: More in Common, *Britons' attitudes to energy bills: the permacrisis that keeps burning*, September 2025.

The Government has grand plans to reform the energy system, aiming to reduce both bill levels and volatility.²⁰ But this will take time. There is no ‘silver bullet’ that can bring down wholesale gas and electricity bills this winter.

In this context, however, there is scope for action to bring down the ‘policy costs’ that are adding to these pressures. These costs are added to electricity bills to pay for government energy and climate policies. Moving them into general taxation would reduce energy bills and bring down the headline rate of inflation. At the same time, this move would address longstanding concerns about how policy costs disproportionately burden lower-income families and impede the UK’s decarbonisation efforts by pushing up the price of electricity relative to gas.²¹

A typical household now spends more than £250 per year on levies on energy bills to pay for social and low carbon programmes. As such, ministers could take steps to minimise their own contribution to bill pressures. The costs of the Warm Homes Discount and Energy Company Obligation – which are, in effect, social-security policies that have been outsourced to electricity bills – and the Renewables Obligation and Feed-in Tariff schemes – ‘closed’ programmes that funded early renewable projects – should be moved from electricity bills to the tax system. On top of this, the Carbon Price Support should be axed, as it adds costs to bills but no longer reduces emissions from the electricity system.²² This would cut typical energy bills by £160 a year – worth more than 1 per cent of annual spending for the poorest three income deciles (Figure 11).²³ It would also reduce CPI inflation by around 0.3 percentage points, support the net zero transition by reducing the disparity in price between electricity and gas, and ensure that welfare policies are funded more equitably than when paid for via bills. But cutting energy bills for all 27 million British households is not cheap: this policy route carries significant costs of £4.3 billion next year, falling to £3.5 billion by 2029-30.

One alternative is to nil-rate VAT on gas and electricity bills, at a cost of £2.5 billion per year.²⁴ This would also help families squeezed by the cost of living, but by less than one focussed on policy costs (saving the average household close to £90 per year). It would also reduce CPI inflation by close to 0.2 percentage points. Doing so would, however, involve spreading discounts across both gas and electricity, perpetuating the high price of electricity relative to gas which is impeding the net zero transition. Cutting VAT on just electricity to sidestep this would roughly halve the per-household saving – see Figure 11.

²⁰ Department for Energy Security and Net Zero, [Clean Power 2030 Action Plan](#), December 2024.

²¹ J Marshall, [Splitting the bill](#), Resolution Foundation, October 2025. <https://doi.org/10.63492/hpc653>

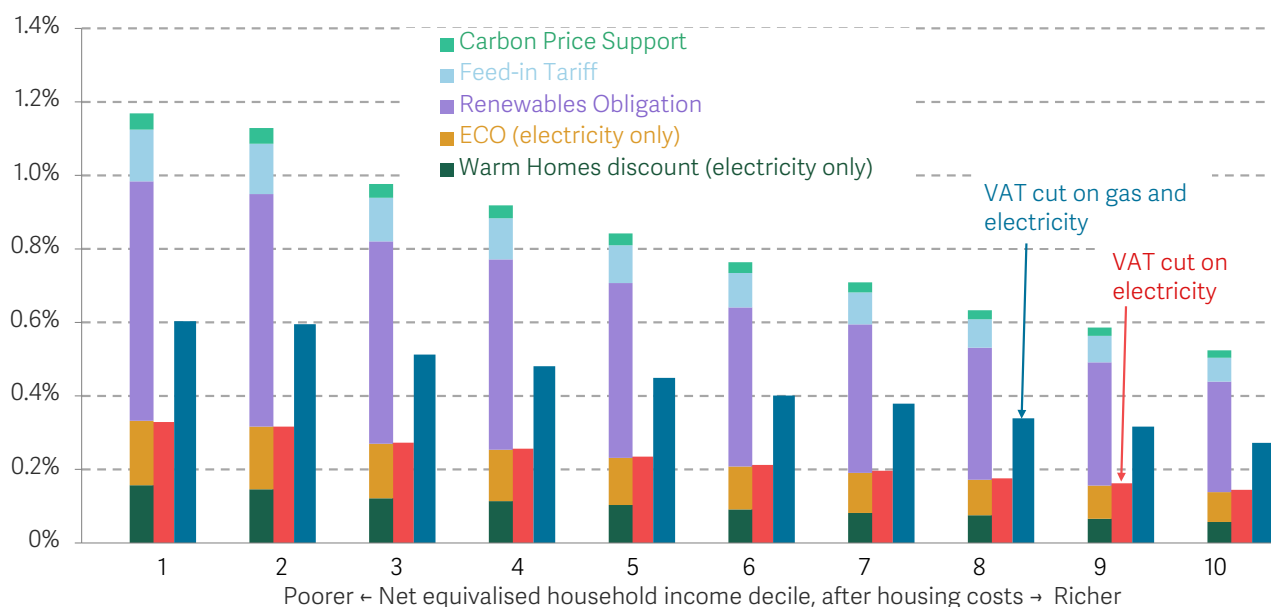
²² For a more detailed discussion of this approach, see: J Marshall, [Splitting the bill: how can Government help families with high energy bills?](#), Resolution Foundation, October 2025. <https://doi.org/10.63492/hpc653>

²³ Note that the average savings as a share of expenditure increases quicker than the additional cost of this policy package in comparison with gas. This is because more of the savings land on energy unit charges and the average figures presented in Figure 4 are dragged up by a small number of very high consuming households.

²⁴ £2.5 billion based on current (Q4 2025) Ofgem price cap levels. Note that VAT on domestic gas and electricity is levied at a reduced rate of 5 per cent.

FIGURE 11: An energy bill VAT cut would offer less benefits to poorer households than funding policies on bills differently

Savings from proposed energy bill policy changes and VAT cuts on both fuels and on electricity only, as a proportion of total expenditure, by equivalised after housing costs income deciles: GB, 2025-26



NOTES: Costs levied on electricity standing charges applied to all households, and those on gas to households that report spending on gas in the LCFS. Annual consumption values derived from LCFS spending data and re-weighted to account for recent changes in Ofgem's typical domestic consumption values (TDCVs).

SOURCE: RF analysis of ONS Living Costs and Food Survey, Ofgem, LCCC, OBR data.

The Government must go further and faster on growth, although little of the policy in this area will be up for grabs at the Budget

The OBR's markdown to trend growth reinforces the need to find ways to expand the size of the economic pie. In this context, the Government had hoped that it could significantly reduce policy uncertainty, creating a favourable tailwind to its growth agenda. But, if anything, such uncertainty has risen since the election last July.²⁵ While this will reflect international as well as domestic factors, delivering growth certainly seems to have been harder than expected for the Government. As discussed in Box 1, a number of policies designed to boost the supply side of the economy have been introduced and it has concluded trade agreements with the EU, India and the US.²⁶

But there are several areas where the Government could do more without incurring significant new spending.

²⁵ Source: 'Measuring Economic Policy Uncertainty' by S Baker, N Bloom and S J Davis at www.PolicyUncertainty.com, accessed 26 October 2025.

²⁶ J D Portes, Growth, September 2025, included in Resolution Foundation and UK In a Changing Europe, *Policy Landscape 2025*, September 2025.

First, it could double down on efforts to identify and remove pinch points to growth through changes to the planning system and accelerating pension reforms (Box 1). This should remain part of the Government's strategy, as should moving beyond identifying legislative barriers towards tackling practical challenges to delivery, such as supply-chain and workforce bottlenecks.²⁷ This should unlock private-sector investment and increase productivity, even if results take time.

Second, the Government should prioritise rebuilding closer economic relations with the EU.²⁸ This means being more ambitious than what was agreed at the UK-EU Summit in May. The OBR has estimated Brexit has reduced long-run trend productivity by 4 per cent, with most of this impact having already weighed upon the economy.²⁹ There are a range of possible agreements the UK and EU could negotiate covering goods, services or people but a substantial agreement on regulatory alignment – which is consistent with the Government's 'red lines' – could also provide a meaningful boost.³⁰

Neither of these areas are decisions for the Budget. Instead, the prime candidate for going faster on growth in November is on tax. Reforms to tax policy that would also support growth include business taxation and property taxation. Most obvious here would be lowering the UK's high VAT registration threshold, which harms growth by encouraging firms to hold down their turnover and could raise £2 billion.³¹ Another measure could be cutting non-residential Stamp Duty Land Tax, which we have previously estimated would cost the government up to £2 billion, to help boost investment and dynamism in the corporate sector.³²

The Government is likely to respond to the deterioration in the public finances with spending cuts and tax rises

The deterioration in the public finances warrants a decisive response from the Government. Borrowing costs have been volatile in recent months with the UK experiencing the highest yields on its debt among rich countries.³³ This means siren-calls for extra borrowing or watering down the fiscal rules come with a risk of financial-market instability. To its credit, the Government has been clear that it plans to meet this deterioration in the fiscal outlook with spending cuts and tax rises.

²⁷ For example, previous RF analysis has shown that one risk to the government's housing targets is the increasing reliance on an aging workforce in the construction sector. See C Aref-Adib, J Marshall & C Pacitti, *Building Blocks: Assessing the role of planning reform in meeting the Government's housing targets*, Resolution Foundation, September 2024. <https://doi.org/10.63492/fvh320>

²⁸ S Dhingra, E Fry, S Hale & N Jia, *The Big Brexit: An assessment of the scale of change to come from Brexit*, Resolution Foundation, June 2022.

²⁹ See Box 2.1 in Office for Budget Responsibility, *Economic and Fiscal Outlook: March 2025*.

³⁰ E Fry & G Thwaites, *The growth mindset: sizing up the Government's growth agenda*, Resolution Foundation, September 2024. <https://doi.org/10.63492/xbgr77>

³¹ A Corlett, *Call of duties: Revenue and reform for Autumn Budget 2025*, Resolution Foundation, September 2025. <https://doi.org/10.63492/urc611>.

³² M Broome, A Corlett & Greg Thwaites, *Tax planning: How to match higher taxes with better taxes*, Resolution Foundation, June 2023.

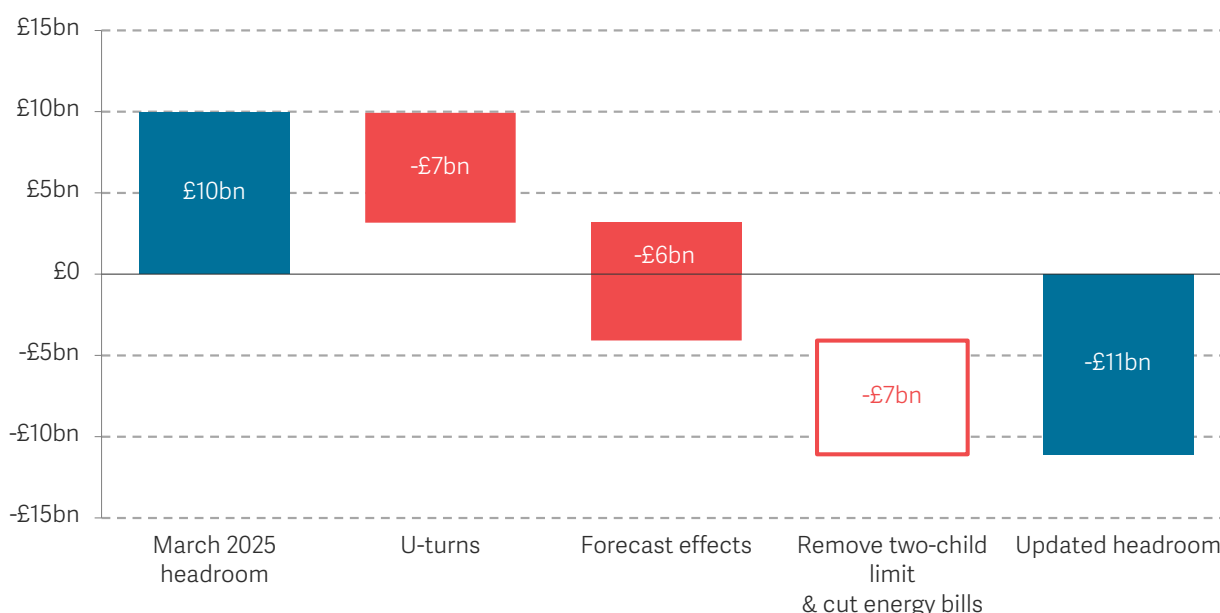
³³ J Smith, *The Macroeconomic Policy Outlook: Q3 2025*, Resolution Foundation, 12 September 2025. <https://doi.org/10.63492/rxn9076>

In designing its response, it is important that policies reinforce the Government's commitment to stable public finances. Most obviously, this should include increasing the 'headroom' – or buffer – against the fiscal rules. At the Spring Statement headroom was very low by historical standards at just £10 billion against the Government's binding fiscal constraint of funding day-to-day spending through tax receipts in 2029-30.³⁴ A number of estimates suggest that this room should be increased to at least £20 billion.³⁵

The deterioration in the public finances is more than enough to wipe out the Chancellor's thin buffer against the fiscal rules in March. As shown in Figure 12, u-turns (£6.8 billion of extra borrowing) and changes to the OBR forecast suggested by our RF update scenario (£7.3 billion) are more than enough to eradicate the amount of headroom held by the Chancellor at the Spring Statement. The additional £7 billion of policy measures outlined above (in the form of abolishing the two-child limit and bringing energy-bill policy costs into general taxation) would imply a total increase in borrowing of around £21 billion. If the Government wanted to increase headroom by £10 billion or, more likely £5 billion, that would mean £26-31 billion of spending cuts or tax rises would need to be found. So below we discuss how a gap of this magnitude could be filled, starting with spending.

FIGURE 12: Headroom is likely to be more than wiped out by u-turns and possible forecast changes

Impact on fiscal headroom of policy changes and possible OBR forecast judgements:
UK



SOURCE: RF analysis of OBR, Economic and fiscal outlook, March 2025.

³⁴ C Aref-Adib et al., *Unsung Britain bears the brunt Putting the 2025 Spring Statement in context*, Resolution Foundation, March 2025. <https://doi.org/10.63492/teo308>

³⁵ D Aikman, *How risky is the UK's debt outlook?*, National Institute of Economic and Social Research, 17 October 2025.

Part of the answer will come from spending

While all the attention has been on tax changes ahead of the Budget, the Chancellor has been clear that she is considering spending cuts too.³⁶ This is understandable given that the OBR's trend growth markdown implies that previous spending plans would account for a bigger share of the economy. So below we look at the options for the Government across welfare and departmental spending.

Welfare spending is set to be higher at the Budget than it was at the Spring Statement following Government u-turns

The political space to reduce welfare spending looks smaller now than it did in March after a significant backbench rebellion removed the savings from planned changes to working-age disability and incapacity benefits. There has been a rise in ill health and disability, and a rise in the cost of these to the welfare system, and the Government should think seriously about how to find savings. However, we should learn the lesson from March that reforms in this area need to be thought through, not rushed, so savings are not an option for this Budget.

There are some measures in the Government's Pathways to Work Green Paper which it could confirm in the Budget, and which would save a small amount.³⁷ First, the Government could introduce a new Unemployment Insurance scheme in place of the current contributory benefits (contribution-based Jobseeker's Allowance, or c-JSA, and Employment and Support Allowance, or c-ESA). Creating a more generous, but time-limited, form of unemployment insurance would be a good move: it would better protect workers' living standards if they experience job loss, contributing to greater dynamism and economic growth by encouraging risk-taking and training.³⁸ This policy change would create savings: there would no longer be any difference between the contributory benefits paid to those unemployed and those out of work because of ill health. That means c-JSA claimants would receive a more-generous payment for a similar duration (currently up to six months), while c-ESA claimants would receive payments of the same value but for a time-limited duration (currently most c-ESA claimants can receive this benefit indefinitely).³⁹

³⁶ A Adu, [Rachel Reeves says tax rises and spending cuts on budget agenda, citing Brexit impact](#), The Guardian, 15 October 2025.

³⁷ DWP, [Pathways to Work: Reforming Benefits and Support to Get Britain Working Green Paper](#), March 2025. See also: M Brewer, A Clegg & L Murphy, [A dangerous road? Examining the 'Pathways to Work' Green Paper](#), Resolution Foundation, March 2025, <https://doi.org/10.63492/fxz2960>; L Murphy, [The good, the bad and the messy: Responding to the Pathways to Work Green Paper consultation](#), Resolution Foundation, June 2025. <https://doi.org/10.63492/wfk812>

³⁸ M Brewer & L Murphy, [From safety net to springboard: Designing an unemployment insurance scheme to protect living standards and boost economic dynamism](#), Resolution Foundation, September 2023.

³⁹ Currently, there are 257,000 people in the c-ESA 'Support Group' who qualify for indefinite support and who do not also receive Universal Credit whose benefit support would decrease, compared to an estimated 49,000 people claiming c-JSA whose support is likely to increase. RF analysis of DWP, Stat-xplore; DWP, Outturn and forecast tables: Spring Statement 2025. The IFS estimate that the Government's proposed unemployment insurance scheme could save between £0.6-1.4 billion a year in the long run depending on the parameters – see: M Mikloš & X Xu, [Options for unemployment insurance](#), Institute for Fiscal Studies, October 2025.

Second, in principle, the Government could reduce spending on incapacity benefits by barring young people aged under 22 from receiving the health element of Universal Credit (UC-Health). This reform would take aim at the worrying rise in the number of young people who are out of work due to ill health. But the change that the Government has consulted on – removing UC-Health just from those aged 16-21 – would barely make a dent in overall health-related benefit spending. There are just 110,000 16-21-year-olds in receipt of UC-Health, and only 74,000 of them receive an additional health-related payment (through the Limited capability for work and work-related activity, or LCWRA, element). If UC-Health was removed from all of these young people, this would save just £375 million in 2025-26 – a tiny fraction of overall health and disability spending.⁴⁰

Of course, the Government could also choose to undertake other welfare reforms to reduce spending, with opposition parties proposing cuts to Personal Independence Payment (PIP) for people with mental health conditions.⁴¹ But it is highly unlikely that the Government would be able to announce cuts like this in the upcoming Budget, not least because the Government has ruled out making changes to PIP before the conclusion of the Timms review in Autumn 2026.⁴² The options for welfare spending to make up any substantial part of the shortfall in the public finances are therefore limited in the short run. That is not to say that the Government should give up on reforms which rebalance support and incentives within the system while also saving money. But considered benefit reform of the type that is badly needed requires time to design and implement and so are not suited to delivering savings at this year's Budget.

The Government could choose to make cuts to departmental spending to address the deterioration in the public finances

The other area where the Government could look to make savings is departmental spending. Matters here are complicated by the Spending Review, published in June. Those plans made the Department of Health and Social Care the big winner. Indeed, health took up 90 per cent of the £19.2 billion (real terms) increases in annual day-to-day spending, with education being a smaller winner receiving 9 per cent of the increase (£1.2 billion).⁴³ The decisions at the Spending Review left the departments excluding Health, Education and Defence having to divide up £1 billion worth of cuts, although some of these departments did go into the 2025 Spending Review in a much healthier position

⁴⁰ J Diniz & L Murphy, False starts: What the UK's growing NEETs problem really looks like, and how to fix it, Resolution Foundation, October 2025, <https://doi.org/10.63492/kvz546>.

⁴¹ See: J McKiernan, [Reform proposes to cut PIP payments to people with anxiety](#), BBC News, 29 October 2025; R Poulter, [Tories confirm plans to cut PIP for mental health claimants](#), The Mirror, 6 October 2025.

⁴² Hansard, [Employment: People with Health Conditions](#), October 2025. Even if the Government reneges on this promise, it would still be unlikely to be able to produce big savings from the benefits system in this Budget, since welfare reforms are usually announced after a consultation process. Indeed, one of the Government's recent attempts at welfare reform was thwarted after it was found to be unlawful due to an improper consultation process. See: P Butler, [Incapacity benefit cuts consultation was 'misleading' and unlawful, judge rules](#), The Guardian, 16 January 2025.

⁴³ C Aref-Adib et al., [A healthy State? Putting the 2025 Spending Review into context](#), Resolution Foundation, June 2025. <https://doi.org/10.63492/pfg738>

than they had been in 2023-24, as a result of the big increase in day-to-day spending at the 2024 Autumn Budget.⁴⁴

Unpicking the 2025 Spending Review plans would be a major undertaking and imply an embarrassing change in the Government's policy programme in short order. That is not impossible, but it is much more likely that the Chancellor will make changes beyond the Spending Review period. To the Government's credit, it set out investment plans until 2029-30, meaning that it is harder to use investment as the margin of adjustment this time without rewriting plans set out in June. That is reinforced by the Government's fiscal rules, which exclude investment spending from the binding constraint on balancing day-to-day spending and taxes in 2029-30. This is in stark contrast to recent episodes of belt-tightening, such as the Coalition Government years, during which annual public investment was cut by 1.1 per cent of national income when compared to 2009-10. This means cuts to day-to-day spending on public services (or Resource Departmental Expenditure Limits, RDEL) in 2029-30 are more likely as existing plans are only in place until 2028-29.

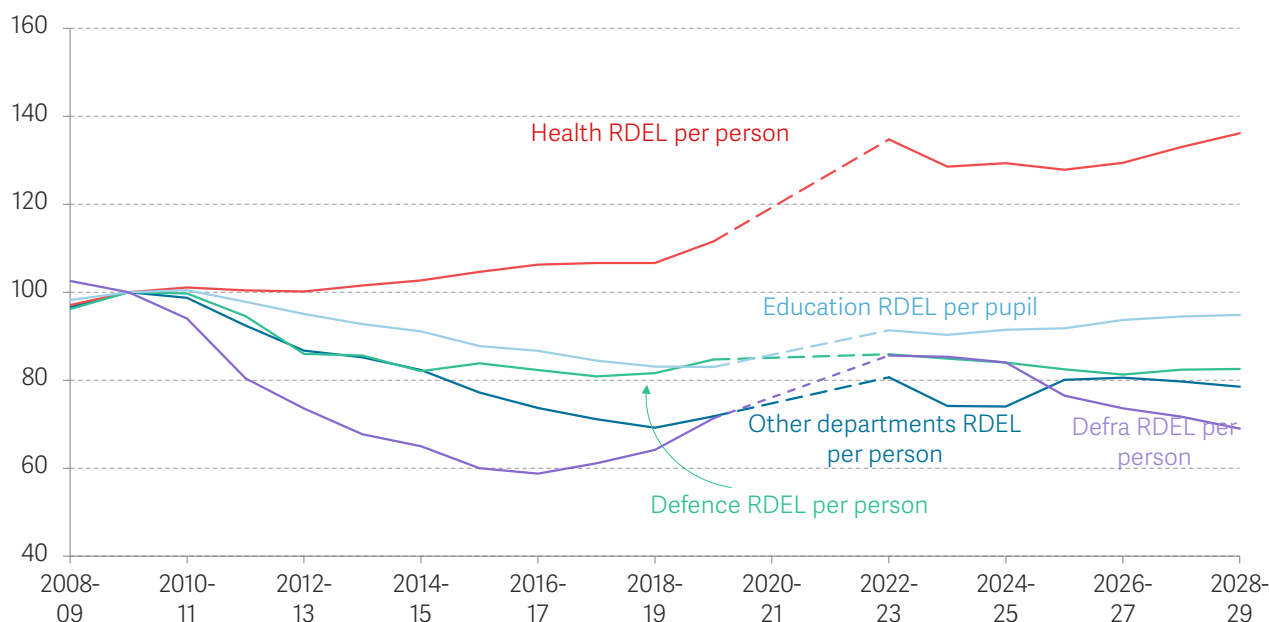
So what could the Government do with the 2029-30 RDEL plans? The OBR currently forecasts 1 per cent real RDEL growth in 2029-30, so freezing the entire RDEL envelope in real terms would save £5 billion. But it is likely that Health, Education and Defence would still need to increase in real terms in 2029-30 in line with the Government's priorities. If Health stayed as the same share of GDP in 2029-30 as 2028-29, and the Core Schools and Defence budget received real-terms increases of 0.4 per cent and 0.7 per cent respectively in 2029-30 (the average annual increases for each department in the Spending Review), that would increase RDEL spending by £6 billion, compared to a real-terms freeze in these three departments. So other departments would need cuts of £6 billion to deliver a freeze in real spending overall.

There are risks to this approach. Most obviously, this strategy would ape the 'fiscal fictions' used by Jeremy Hunt during the previous Parliament, with unrealistic spending plans pencilled in for after the next election. More regular spending reviews address this risk to some extent, as would laying out specific ways in which savings could be delivered in 2029-30. But it is still the case that some departments already facing significant cuts would have to go even further. If we factor in changes to the size of the population, the Department for Environment, Food and Rural Affairs (Defra), for example, is already facing real-terms per-person cuts of 10 per cent over the Spending Review period.

⁴⁴ C Aref-Adib et al., *A healthy State? Putting the 2025 Spending Review into context*, Resolution Foundation, June 2025. <https://doi.org/10.63492/pfg738>

FIGURE 13: The likes of Defra are already facing significant real-terms per-person funding cuts

Indices of real per-person resource departmental expenditure limits (2009-10 = 100), by selected departments and other departments: UK



NOTES: Deflated using the OBR forecast for the GDP deflator. Other departments include everything apart from DHSC, Education, Defence and Defra. Figures include the impact of Barnett consequential. Education shown per pupil.

SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, various; HM Treasury, Budget and Spending Review documents, various; Explore Education.

To make matters worse, there are upside risks to day-to-day public spending. Recent reports suggest that the NHS will need to pay up to 25 per cent more for medicines (to put this in context, the NHS spent a total of £20.6 billion on medicines in 2023-24).⁴⁵ Meanwhile, there are challenges over public sector pay (the teachers' pay review body recommendation of a 4 per cent pay rise for 2025-26, accepted by the Government, was significantly higher than the 2.8 per cent the Education department said it could initially afford), and unrelenting pressure on defence spending with little scope to continue increasing defence spending via CDEL alone.

This highlights the difficulties in delivering day-to-day spending cuts given some of the pressures on public services. Saving around £5 billion from RDEL budgets in 2029-30 is far from a pain-free option but is probably the most practical given constraints on other forms of spending at this Budget. Giving a sense of where spending cuts could fall should also help reduce the extent to which this is perceived purely as a 'fiscal fiction'. In doing so, the Government should be mindful of its wider living standards goals, prioritising public services which are used heavily by lower-income families and/or help

⁴⁵ J Kollwe & E Courea, [NHS could pay 25% more for medicines under plan to end row with drugmakers and Trump](#), The Guardian, 8 October 2025; C Duddy, [How are medicines prices set in the UK?](#), House of Commons Library, July 2025; B Chu, [Why might public sector workers go on strike again?](#), BBC, 28 April 2025.

with growth, such as adult social care, special educational needs, apprenticeships for young people and, even within health spending, favouring GP spending.

All this means taxes are going up – but the Government must have a plan

As a reminder, the £21 billion deterioration in borrowing from the worse economic outlook, including £7 billion of critical spending to support living standards (Figure 12), suggests a need to raise taxes by £21-26 billion in order to increase headroom by £5-10 billion, assuming the Government also makes £5 billion of targeted cuts to spending.

It is possible to raise significant sums through a series of smaller reforms

In previous work we set out in detail what we think would be the best tax options for responding to this gap.⁴⁶ Budget tax changes must rise to the challenge of providing a clear and decisive response to the deterioration in the public finances. This means increases that are large – and, crucially, reliable enough – to allow the Chancellor to increase headroom by at least £5 billion in 2029-30, as well as setting out a direction of travel for the tax system that reassures markets that there is a plan if the public finances deteriorate further. But policy must also respond to the economic circumstances of the country – particularly avoiding damaging growth or increasing inflation. And the Chancellor should put the burden on those with higher living standards who currently face lower tax rates.

Tax rises themselves (leaving aside the harms of not raising sufficient money) generally come with economic downsides. But these can be minimised by choosing tax reforms that reduce the drag of our £1 trillion tax system on the economy. There is no one way to do this; our tax system has much scope for improvement. Table 1 sets out a range of options for the Government that are consistent with setting out a clear path of reform while also reliably raising revenue by 2029-30.

⁴⁶ A Corlett, Call of duties: Revenue and reform for Autumn Budget 2025, Resolution Foundation, September 2025. <https://doi.org/10.63492/urc611>

TABLE 1: A range of measures are consistent with improving the tax system in three key areas

	Measure	2029-30, nominal, £bn, rounded
Fairness across businesses	Reduce small business tax gap	2
	Reduce VAT threshold	2
	Introduce Membership NI for LLPs	1
	Reduce salary sacrifice benefit for employers	1
	<i>Subtotal</i>	6
Fairness across individuals	End ways to side-step CGT	4
	Raise basic rate of dividend tax	1.5
	Raise IT rates by 2p, but cut employee NI by 2p	6
	Extend higher rate threshold freeze	3
	Extend personal tax allowance freeze	4.5
	<i>Subtotal</i>	19
Taxing harms	Deliver planned Fuel Duty increases	0
	Reform VED for future vehicles, but cut charging VAT	2
	Broaden UK Emissions Trading Scheme	2
	Reform gambling duties	1
	Introduce sugar and salt levy, but scrap soft drinks levy	3.5
	<i>Subtotal</i>	8.5
	<i>Total</i>	33.5

NOTES: All rounded to the nearest £0.5bn. LLP = Limited Liability Partnership.

SOURCE: RF calculations, including use of the IPPR tax-benefit model; HMRC, Direct effects of illustrative tax changes, June 2025; HMRC, Tax relief statistics, December 2024; HMRC, Private pension statistics, July 2025; CenTax; National Food Strategy.

A key question for the Government is whether it would be better to rely more on a single big tax change. One large measure – particularly if it comes with an end to the Government’s manifesto commitment not to raise the main rates of Income Tax, National Insurance (NI), VAT or Corporation Tax, could help reassure markets and spread the burden across a wider base. But it may also do less to put the wider tax system on a reforming path. Indeed, getting the right policy in light of these tough circumstances should override considerations around the number of measures needed to get there. Meanwhile, politically at least, there may be arguments for the Government avoiding a long list of rows with particular groups. But the Labour Manifesto made it clear that this Government wants to avoid large tax rises on employees and that goal will have been made more relevant by the large rises in employer National Insurance at last year’s Autumn Budget.⁴⁷

⁴⁷ A Corlett, It’s personal (taxation): Taxes on typical employees aren’t unusually high, but the bias against them is, Resolution Foundation, October 2025. <https://doi.org/10.63492/vzw6992>

Whether the Government needs to break from its manifesto will depend above all on the size of the downgrade. It is very hard to see how very large sums could be achieved without raising those major taxes. But some options would be better than others. The employer NI rate rise and threshold cut should not be repeated, nor employee NI raised. Going against very explicit promises about the stability of the Corporation Tax rate would reduce trust in the UK. And the Chancellor's comments that "There's a shared job between the Bank of England and the government to bear down further on some of the causes of inflation" suggest that the Government may be unlikely to raise VAT rates given how this would complicate the bringing down of interest rates and inflation.⁴⁸ This leaves Income Tax – or the scope of NI – with options surrounding both rates and thresholds as the most promising choices among these major taxes.

In our list of suggestions in Table 1, freezing the £12,570 personal tax allowance and the £50,270 higher-rate threshold for an extra two years would raise £7.5 billion by 2029-30. This broad tax rise would affect employees – with a loss of around £140 for basic-rate employees in 2029-30 – but experience shows that freezes are deliverable and would not represent an egregious reneging of manifesto commitments. Moreover, raising effective tax rates can be justified by relatively low levels of taxation for most groups by international and historical standards.⁴⁹ All this means that continued freezes – or at least under-indexing – are very likely to be part of the Budget package. Freezing the (now) £5,000 employer NI threshold for an extra two years would raise around another £1 billion in 2029-30. But given the scale of the 2025 employer NI rise, job market weakness, and the bias against wages in the tax system, it would be better to avoid that. It would be fairer to raise a similar sum (or more) from reducing the employer NI relief for employer pension contributions.⁵⁰

Income Tax rate rises are the only option that remains to raise large sums. A 1p rise in the basic, higher and additional rates would raise over £10 billion.

However, we have argued that some forms of income should be prioritised over others for tax rate rises, given existing but poorly justified differences, and given the employer NI rise. Income Tax rate rises could therefore be accompanied by employee NI rate cuts – which would move the UK closer to being able to abolish this part of the tax system if it wished to. In our earlier work, we looked at a 2p switch from employee NI to Income Tax which would therefore in general leave employees unaffected while raising rates on

⁴⁸ See: F Islam, *Reeves plans 'targeted action' on bills in Budget*, BBC News, October 2025.

⁴⁹ A Corlett, *It's personal (taxation): Taxes on typical employees aren't unusually high, but the bias against them is*, Resolution Foundation, October 2025. <https://doi.org/10.63492/vzw6992>

⁵⁰ We made a specific suggestion of raising employer NI on pension salary sacrifice arrangements, at half the usual rate, which would raise upwards of £1 billion. A Corlett, *Call of duties: Revenue and reform for Autumn Budget 2025*, Resolution Foundation, September 2025. <https://doi.org/10.63492/urc611>

other forms of income by 2p – with a net fiscal benefit of £6 billion a year.⁵¹ This would particularly raise taxes on pensioners, the self-employed and some capital income, who all face lower tax rates than working-age employees. But pensioners' living standards have increased by much more than those of working age – typical pensioner incomes have increased by 21 per cent over the past 20 years compared with just 4 per cent for those of working age – and with the state pension going up £560 next April, only pensioners with incomes above £40,000 would be worse off overall in cash terms.

If Income Tax rates were to materially change, there are also a number of other reforms that could be considered to make this a reforming as well as revenue-raising change. The abrupt removal of childcare subsidies at £100,000; the extra-high marginal rates created by the tapering away of the personal allowance and Child Benefit; the existence and means testing of the marriage tax allowance; and the complicated starting rate band for savings income are all parts of the income taxation system that could clearly be improved.

Below we look at four other tax challenges that the Treasury should try to tackle whether the hole is £10 billion or £50 billion; their inclusion represents a good test of whether this is a significant reforming Budget.

1. Reduce tax differences between wages and self-employment (and other) income

The previous Budget's focus on employer NI, together with the accumulation of other tax choices over time, has led to taxes for a median employee now being a record high 55 per cent higher than those for an equivalent self-employed worker.⁵² It has long been recognised that this tax difference, due to the lack of employer NI for the self-employed together with a lower personal basic NI rate, is hard to justify, and we have set out how this is bad for productivity. Given a total self-employment NI bias estimated at £9 billion in 2025-26 – likely rising to over £10 billion in this Parliament unless action is taken – there is also significant revenue-raising potential from reform in this area.

One option would be to extend a form of employer NI to partnership income (a sub-set of self-employment income) – or potentially to Limited Liability Partnerships, particularly given that these are similar to typical companies, have a prevalence of very high earnings within them, and are limited in numbers. Previous work explores these options in more detail, but £2 billion could be raised if all partnership income were covered.⁵³

⁵¹ Any Income Tax changes other than to the personal allowance would only indirectly affect Scotland, with the Scottish Government having the power to decide whether or not to mirror changes. Our 2p tax switch proposal would essentially devolve more tax power to Scotland.

⁵² A Corlett, It's personal (taxation): Taxes on typical employees aren't unusually high, but the bias against them is, Resolution Foundation, October 2025. <https://doi.org/10.63492/vzw6992>

⁵³ A Advani et al., Equalising National Insurance on Partnership Income: Revenue and Distributional Effects, CenTax, September 2025.

But the case is equally strong for broader self-employment tax rises (which is one of the things the 2p tax switch idea would deliver). For the basic rate, a 2p rise would align with the rate paid by employees while still being less burdensome than the system in place before 2024 (when the rate was cut by 3p and compulsory Class 2 payments abolished). This would be particularly fair if the mooted Unemployment Insurance scheme were also to include the self-employed, as the Government provisionally intends. And, as with the partnership income proposal, rate rises for higher self-employed earners would also be appropriate.

At the same time, it would also be fair for the basic rate of dividend tax to be increased (with options for someone's work to be delivered either via employment, self-employment or a company structure). Account must be taken of the Corporation Tax paid on profits, but the 8.75 per cent basic rate remains low by any standard – with 16.5 per cent (if not more) being an appropriate choice for parity with wages overall.⁵⁴ We have also argued that taxes on rental income in particular should begin to account for NI too.⁵⁵ All of these changes would move towards a more consistent treatment of all income sources – reducing distortions to decisions about different kinds of work and investment.

2. Improve the effectiveness of taxes on wealth

A sensible response to calls for a net wealth tax is that it would be more efficient and less risky to simply improve the taxes that we already have. But the latter must include changes to the base of Capital Gains Tax (CGT).

At present, it is possible to build up unrealised capital gains within a company (including through simply retaining earnings) without personal taxation and then have these gains written off through one of two mechanisms. One is to leave the UK, and the other is to hold on to the asset until death (though it could still be leveraged to provide income during life). These gaps are both unfair on other taxpayers and incredibly distortionary: even those who favour lower CGT rates should want a more efficient system that does not include these features.⁵⁶

Our previous work explores the relevant design questions and academic research in further detail, but reform here is crucial for plugging holes in the CGT and income taxation system. With a current top CGT rate of 24 per cent (lower than the starting rate for employees of 28 per cent), it is not unreasonable to ask the very wealthiest to pay more than zero tax.

⁵⁴ A Corlett, Call of duties: Revenue and reform for Autumn Budget 2025, Resolution Foundation, September 2025. <https://doi.org/10.63492/urc611>

⁵⁵ A Corlett, Call of duties: Revenue and reform for Autumn Budget 2025, Resolution Foundation, September 2025. <https://doi.org/10.63492/urc611>

⁵⁶ L Msall & O Næss, *Never-Realized Capital Gains*, June 2025.

3. Take steps to reform property taxes

Annual taxes on immovable property may be the least economically harmful tax.⁵⁷ But at the same time, it is commonly accepted that the English Council Tax is outdated, with valuations based on 1 April 1991 – over a third of a century ago. Relative to property value, the least valuable properties are charged much more than those of higher value.⁵⁸ Meanwhile, Stamp Duty Land Tax is perhaps the country's most economically damaging tax.⁵⁹ There is, therefore, a lot of potential for sensible tax reform. It may be that it is easier to make major improvements to Stamp Duty when the fiscal position is more favourable, but there have been a number of rumours about possible Budget measures in this space.

The distribution of Council Tax across England will be influenced by the 'Fair Funding Review 2.0'.⁶⁰ The decisions within that may be more important than those below for the regional distribution of local authority funding. But there remains a good case for moving towards a more proportional property tax, and away from the current system of eight bands where the most valuable properties in each area are charged only three times as much as the least valuable.

A limited option would be to simply change existing multipliers. Recent research implies that a 50 per cent Council Tax increase for Bands G and H would raise £2.1 billion in 2029-30.⁶¹ More elegant options include increasing the number of bands, or at least have a proportional tax for the top of the distribution. For comparison, Wales has nine bands rather than eight; Scotland is consulting on possible options including 12- or 14-band systems;⁶² Northern Ireland retains a proportional (but capped) approach; and Ireland has 19 bands plus a proportional charge for values beyond €2.1 million. In England, an annual charge of 0.5 per cent of value above £2 million has been estimated to raise over £1 billion.⁶³ However, a choice would need to be made as to whether money from any such changes would go to councils – potentially helping some London councils deal with the implications of the Fair Funding Review – or to central Government.

There is also the question of revaluation. Although, again, it is the Fair Funding Review that can most easily achieve regional rebalancing revaluation is also important within councils. And if the Government wanted to reform property taxes at the top (or more broadly) it would not be ideal to do this based on 1991 valuations. One option to consider might be to use the Valuation Office Agency's Automated Valuation Model to relatively

⁵⁷ OECD, *Tax Policy Reform and Economic Growth*, November 2010.

⁵⁸ L Try, *Money, money, money: The shifting mix of income sources for poorer households over the last 30 years*, Resolution Foundation, February 2025, <https://doi.org/10.63492/p3505p>; and M Broome, A Corlett & G Thwaites, *Tax planning: How to match higher taxes with better taxes*, Resolution Foundation, June 2023.

⁵⁹ L Cao et al., *Understanding the economy-wide efficiency and incidence of major Australian taxes*, Treasury Working Paper, April 2015.

⁶⁰ Ministry of Housing, Communities & Local Government, *The Fair Funding Review 2.0*, June 2025.

⁶¹ S Adam et al., *Green Budget 2025: Full report*, Institute for Fiscal Studies, October 2025.

⁶² Scottish Government, *Future of council tax in Scotland: consultation*, October 2025.

⁶³ Tax Policy Associates, *Council tax on expensive homes: could the Budget raise £1bn+?*, August 2025.

easily estimate every property's value and then only reform Council Tax (e.g. adding a new band or creating a proportional tax) for the very top of the updated value distribution. Ideally, the lowest value properties could also be given lower bills as part of a new lower bottom band, all potentially without making any band changes for the majority of properties in the middle.

There would also be the option of using some of any revenue raised to cut Stamp Duty. It is notable that cutting the top rate of Stamp Duty from 12 per cent to 11 per cent could raise an estimated £35 million (through increased transaction volumes), and that the penultimate rate could be cut from 10 per cent to 9 per cent for only £35 million.⁶⁴ A combination of the Fair Funding Review, greater proportionality, some use of up-to-date valuations and some Stamp Duty changes would be a significant reforming moment, even if its impact on the public finances and on most households were limited.

Another rumoured option is to make some change to the £32 billion a year relief that exempts main residences from CGT – perhaps focused on high-value and/or high-gain properties.⁶⁵ Previous Resolution Foundation research explored these policy options in detail.⁶⁶ There is a good argument that own residences should not be totally CGT-exempt, and although there is potential to raise revenue here, there are also tricky design considerations. Such a policy would heighten questions about whether merely inflation-tracking gains should be exempt from CGT (or whether the 24 per cent top CGT rate implicitly recognises this). It would need to avoid discouraging moves – particularly if Stamp Duty were unreformed – and in practice that might often mean that gains are only taxed at death.

4. Put motoring taxes on a more sustainable footing

Two crucial reforms the Budget could make are to motoring taxes, to boost the credibility of the UK's public finances in both the medium and long-term. First, the Fuel Duty freeze should end. As Figure 14 shows, the real value of Fuel Duty has been cut by a third (23p per litre) over the past decade, and the cost of petrol is low by the standards of the past 20 years. Attempting to continue the freeze indefinitely would mean the Chancellor had chosen to commit £5 billion in 2029-30 to lowering Fuel Duty, and any such sums would be far better directed at cutting electricity bills and reducing poverty, as we set out earlier. Simply going ahead with existing plans would still leave real Fuel Duty levels lower than at any point through 1994 to 2021.

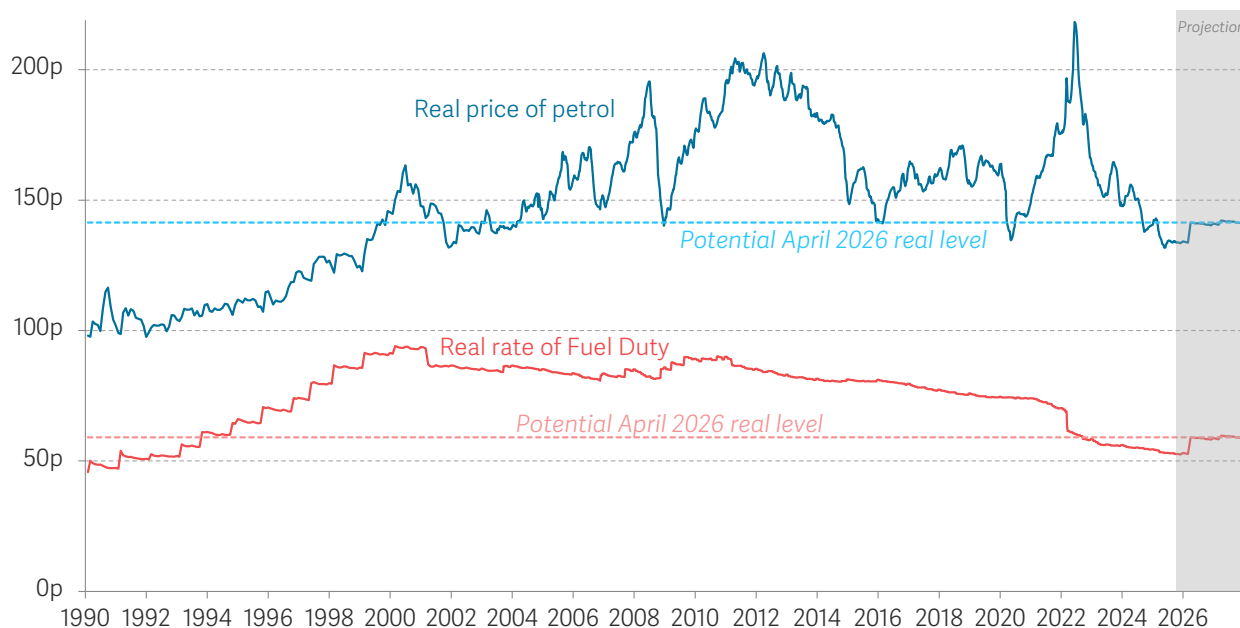
⁶⁴ HMRC, [Direct effects of illustrative tax changes bulletin](#), June 2025.

⁶⁵ HMRC, [Tax relief statistics](#), December 2024; A Murray, [Rachel Reeves considers 'mansion tax' on homes above £1.5m](#), City AM, 20 August 2025.

⁶⁶ A Corlett & J Leslie, [Home county: options for taxing main residence capital gains](#), Resolution Foundation, December 2021.

FIGURE 14: Petrol and Fuel Duty are both historically cheap: permanently cancelling scheduled rises should not be a priority

Real values of petrol and Fuel Duty per litre: UK



NOTES: CPI adjusted to September 2025 prices. Petrol price projection assumes no real changes except for the impact of Fuel Duty changes (including VAT). Projections based on default policies prior to Budget 2025.

SOURCE: RF analysis of OBR, Economic and fiscal outlook, March 2025; ONS; DESNZ, Weekly road fuel prices; IFS, Tax facts.

That said, the default uprating plan that is currently included in the OBR outlook – which includes both the ending of a temporary 5p cut and the restoration of RPI-linked increases – may be more than politicians can stomach for Spring 2026, particularly given the reasonable desire to bring down inflation. We have suggested that increases should indeed begin early next year, but that the 5p rise could be staggered, annual uprating could be replaced by quarterly changes, and that the RPI link could be replaced by predictable, fixed increases (e.g. the equivalent of 3 per cent a year). Such system would avoid large jumps and annual Fuel Duty decision drama, while reassuring markets that there is no longer any fiscal friction about Fuel Duty plans. As with our suggestions for electricity prices, it would also help deliver lower inflation in 2026.

Second, VED should be reformed, not least with an eye on asking more from electric vehicles over the longer-term to offset future declines in Fuel Duty revenue. The Boris Johnson Government noted that “As we move forward with this [green] transition, we will need to ensure that the tax system encourages the uptake of EVs and that revenue from motoring taxes keeps pace with this change, to ensure we can continue to fund the first-class public services and infrastructure that people and families across the UK expect.”⁶⁷ The current EV VED system – with £10 in the first year and £195 in subsequent years –

⁶⁷ HMG, *The ten point plan for a green industrial revolution*, November 2020.

does not deliver this goal. Nor is it particularly distributionally fair given its generally flat rate and lower rate for brand new cars, together with higher VAT (20 per cent) on public charging than on home charging (5 per cent). It is also not well linked to any particular harms, whereas taxes should ideally relate to road use or footprint, congestion, pollution, noise or safety.

We've estimated that around £2 billion could be raised in 2029-30, and much more in the long-term through a series of changes. First, EV VED for vehicles sold in future should be linked to both miles driven each year and the weight of the vehicle (which correlates with a range of harms as well as vehicle value). Second, as well as exempting existing drivers, this could be somewhat offset by discounts for vehicles sold over the next few years by ending the VAT 'pavement tax', and by ending the Expensive Car Supplement for EVs. And third, VED should also rise for non-EVs sold in future (before these are no longer available from 2035) to keep the EV transition on track and to encourage smaller, greener vehicles within non-EVs too.

Progress on the four tax policy challenges above would naturally be opposed by some of those impacted, but they – as well as the balance of electricity and gas charges explored earlier – have long been recognised as problems in the UK tax system.⁶⁸ It should be hard to argue against beginning to grapple with these as part of the country's drive for stronger growth and for increased confidence that the UK can sensibly and efficiently bring in revenue in future.

Tax rises are coming in the Budget but the Chancellor should prioritise sensible reforms

Although there is no doubt that the outlook for public finances has deteriorated, there is much uncertainty about exactly how much. The OBR's long-awaited downgrade to trend growth will hit borrowing forecasts hard, but the impact looks likely to be backloaded, and therefore smaller than feared. Coupled with improved forecasts for pay, which is crucial for tax receipts, there is scope for the outlook to be a little less bleak than many expected even a couple of months ago.

Nonetheless, we estimate that u-turns, higher interest payments and a worse economic outlook have collectively blown a £14 billion black hole in the public finances by 2029-30. The Government must respond decisively to this challenge given jitters in financial markets in recent months. That means increasing headroom and setting out a path for improving the tax system to build credibility about how the Government will respond if the fiscal outlook deteriorates further. The Chancellor has been clear that spending will take up some of the slack. But there are no easy options here. Freezing spending on

⁶⁸ See for example: S Adam et al., [Tax by design](#), Institute for Fiscal Studies, September 2011.

day-to-day public services means the Government can avoid unpicking this summer's Spending Review while also saving £5 billion. But it must also find room to make good on commitments to bring down child poverty and help protect struggling families with high energy prices.

Tax rises are inevitable, however. Here, the priority should be reforms that improve the system. Although abolishing the two-child limit and helping families with the high cost of electricity should be high priority for the Chancellor, spending here could leave the Chancellor scrambling to find tax rises of up to £31 billion. If this is the case, raising one of the big taxes is justified, and this should be Income Tax. Doing so while reducing distortion in the taxation of different forms of income, improving wealth and housing taxes, and/or futureproofing motoring taxes would be a major step forward. This would surely help build confidence in the public finances as well as contributing to putting the tax system on the road to improvement.

Annex 1: Data citations

- Family Resources Survey (series page [here](#)):
 - Department for Work and Pensions, NatCen Social Research. (2021). Family Resources Survey. [data series]. 4th Release. UK Data Service. SN: 200017, DOI: <http://doi.org/10.5255/UKDA-Series-200017>
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