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How to reset Britain's economic policy

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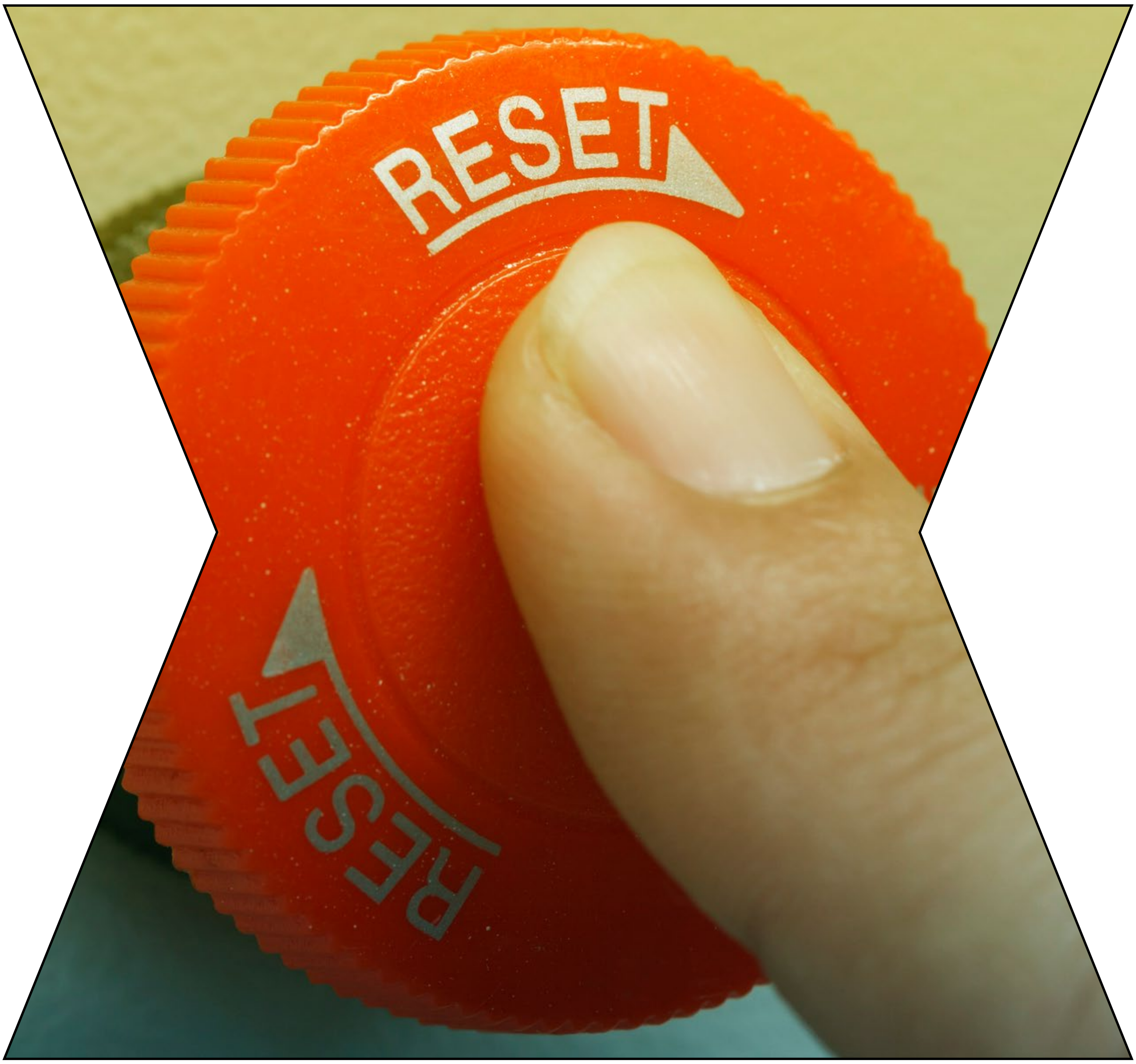

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Executive Summary

Honesty, they say, must be the starting point for repairing any relationship. Today's rancorous relationship with voters can be traced back to the election campaign when Labour insisted it could transform growth and repair public services without huge tax rises. Despite announcing £70 billion of annual tax rises by the end of the decade, public services continue to deteriorate. So, as the Government contemplates how to reset its policy agenda following disastrous local election results, the indispensable precondition is an honest assessment of where the country stands.

Stagnation continues – and with it the big squeeze

The first hard truth to confront is that the economy continues to splutter and stall rather than motor ahead. Forecasts for growth over this Parliament have tended to be revised down rather than up and now suggest a cumulative advance of only 6.8 per cent – less than the G7 average and far less than the US. Crucially, it is a slower rate of expansion than expected before the election, and much weaker than even over the difficult decade of recovery from the financial crisis, let alone the more buoyant days that preceded it.

Britains' sluggish post-pandemic bounce back had already taken a heavy toll on living standards across the range – and an appalling toll on the poorest families. Median incomes for working-age families have crawled up annually by just 0.2 per cent between 2021-22 and 2025-26, a fraction of the 1.3 per cent a year increase witnessed over the two decades before the pandemic. For many poorer families, real annual incomes fell over those four years – and, at the bottom, sank on average by nearly £1,800 (16.0 per cent). This year had been looking much brighter, especially for those on the lowest incomes, thanks to modest, above-inflation increases in UC and the end of the two-child limit. But a new cost of living shock is resulting from US-Israeli strikes on Iran. This threatens to turn an expected rise in typical incomes of 1.2 percent this year into a fall of 0.5 percent, a difference of £550. That extra inflation bites even harder for those on lower incomes.

However, not all families have struggled to the same extent. Typical pensioner incomes have outperformed those of working-age families: the incomes of pensioners at the 25th percentile increased far more (by 3.1 per cent) between 2021-22 and 2025-26 than of working-age families, who saw incomes increase by 1.0 per cent in the same period. Over the last few decades, wealthier families have also fared better. The richest 10 per cent received 28 per cent of the country's income, while the wealthiest 10 per cent own half of the country's wealth.

The coming crunch in the public finances

In the face of such a grim outlook, politicians might be tempted to hope that something would turn up. But today's 'muddling through' is ceasing to be a viable option. This reality is clearest in financial markets where investors are demanding higher returns to lend to the UK than any other G7 country. On top of that, the Bank of England's middle scenario for the hit to the economy from the conflict in the Middle East suggests borrowing will be around £16 billion higher in 2029-30 than expected at the time of the Spring Forecast. While it is to the Chancellor's credit that headroom is set to levels that can withstand such a shock – one that is comparable in size to that in the aftermath of the Brexit referendum – it leaves little room left for sweeteners ahead of the next election.

Public spending should be the happier part of the public-finance picture. This Parliament started with large increases in departmental budgets which should give scope to deliver improving public services. But the rises had a 'sugar rush' profile: most of the extra money arrived at the start of the term, while showing continued improvements later having to rely on wise early decisions about investment and reform. Another – bigger – constraint is the commitment to further increase defence spending. Keir Starmer signed up to the principle of the new NATO target of defence spending of 3.5 per cent of GDP by 2035. Even the intermediate commitment to ramping up defence to 3 per cent by the end of this Parliament would require finding around an extra £13 billion for day-to-day spending.

Doubling down on growth

With the Government's popularity plumbing new depths, it may seem tempting to rip up its central mission of boosting Britain's ailing growth. But this would be exactly the wrong approach. Growth isn't all that matters for living standards, but over the long run it dominates – crucially, expanding the economic pie boosts wage growth. Policy progress has been made. Reforming the fiscal framework to reverse inherited cuts to public investment was bold. So have been measures to boost private investment, including pension fund reforms, new Trade and Industrial Strategies. Alongside this, the Government has pursued supply-side reforms, including on regulation – with a particular focus on planning, where businesses report the greatest regulatory complexity – and skills provision. Increasing the growth rate means doing an awful lot of good things for a long time. Nevertheless, there are those who would say progress has been too slow and too timid given the vast scale of the challenge. What, concretely, would it mean to double down on growth?

Trade is one area where delivery has undershot ambition. Yes, there has been some progress in the form of new agreements with India and the US. But there's much more to do, particularly on the UK's relationship with the EU, where closer integration could deliver material gains. The biggest single step here would be negotiating a single market for goods. But liberalising services trade would also be a positive step, as would delivering on the promise of 'dynamic alignment' for key sectors.

Britain won't grow without investment. While recent governments have rightly moved towards allowing for 'full expensing' of plant and machinery, the expenditure enjoying this break could be widened to cover a wider range of assets, including intangibles. Likewise, Stamp Duty discourages businesses from building, putting sand in the wheels of economic dynamism. Simply abolishing Stamp Duties and the £17 billion in revenues they bring is not a viable option for a cash-strapped government, but well-designed cuts can help reduce its role in holding us back. Improvements here can be complemented by measures to boost house building, an area in which reforms are yet to have an appreciable impact on housing starts. Measures to reverse this should include a London-specific 'delivery package,' plus more national reforms including the streamlining of the new Building Safety Regulator.

With public money tight, there should be attention on revenues. Here, the Government must be far bolder in identifying reforms which can both bolster the potential for long-term growth and bring in revenue to deal with more immediate problems. Reducing the turnover threshold for VAT registration from £90,000 to £30,000 would bring in £2 billion by 2029-30, and would also tackle the incentive for small firms to hold down turnover to remain below the threshold.

Putting work before wealth, and giving the young their due

The Government cannot continue trying to be all things to all people. A policy agenda focused on improving living standards means rebalancing the way the Government both taxes and spends – in favour of those who have faced the worst of recent squeezes. That means putting earners ahead of owners and working-age families ahead of pensioners. But even within that it should give special priority to the very poorest, and also to the youngest, who today confront a welter of adverse trends sprawling across the labour market, mental health problems and historically low homeownership. To these ends, we offer some tangible directions along which policy can advance.

Capital taxes as a share of GDP have not risen in line with the doubling of wealth relative to national income since 1980, and cry out for reform. Council Tax is regressive by design, ignoring the varied and often dramatic trends in house prices in different parts of the country, still being based – absurdly – on 1991 valuations. The transition needs to be considered, but the appropriate direction of travel should obviously be towards a proportional property tax based on up-to-date valuations. A revenue-neutral reform would leave most households better off, raking in most from residents of expensive houses.

Escape routes from Capital Gains Tax should be closed. The UK is internationally unusual in not applying a 'settling up charge' on gains relating to assets of people leaving the country. By giving an automatic write-off to gains at death, the system inculcates a perverse incentive to hold onto assets until the very end. Closing these loopholes could raise £4 billion. Fixing the tax base would enable changes that are more even handed between different types of income, including by raising the marginal rates for capital gains on shares to match Income Tax rates on dividends.

Meanwhile, tax loopholes that benefit the rich and distort behaviour should be addressed. The income of partners at Limited Liability Partnerships should be made liable to employer National Insurance on the same basis as that of regular earners. A wider imbalance in the tax treatment of earnings from work and income from wealth arises because earnings are liable to National Insurance, while investment incomes are not. And tax reliefs targeted at older groups should be restricted, including by scaling back the tax-free lump sum enjoyed by rich pensioners.

We should also recognise that pensioners account for the majority of the social security bill. Spending here will, inevitably, rise as society ages. But we need to resist ramping it up beyond what the demographics require. So it is high time to end the indefinite commitment to the 'Triple Lock' uprating and replace it with a smoothed earnings link which will, over time, maintain the pension's target value relative to earnings.

Working age social security is broadly stable as a share of national income despite disingenuous claims it is 'out of control'. This is money that directly supports family budgets and living standards, particularly towards the bottom end. As such, it is incumbent on anyone claiming big savings in this area – perhaps to 'pay for defence' – to explain exactly what they mean. Nonetheless, the Government has a duty to ensure that existing spending is targeted as tightly as possible.

Today's Local Housing Allowance fails on that test. It is no longer pegged to modest typical rents, but by default frozen. Renters have to dig ever-deeper into already-low incomes to keep a roof over their head: the average shortfall between what the LHA covers and the actual rent paid on an English two-bed is now £165 per month – and rising. Restoring the previous link with rents would cost £2.5 billion in 2029-30. If this had to be financed from within the working-age welfare budget, one way to fund it would be to increase the 'taper' on Universal Credit from 55 to 59 per cent – an option not without downsides, but one that would make the benefits system more equitable overall.

Moving to services and wider support, technology, innovation and organisational reform must be deployed to make resources stretch further where possible. But where not, the language of priorities must again be the order of the day. Day-to-day departmental budgets have risen by 2.3 per cent since the election, and further top-ups are unrealistic. Living within current settlements is likely to require a degree of restraint in public-sector pay. Ministers are duty bound to consider recruitment, retention and the knock-on effect on service quality, but should be wary of claims for automatic 'cost of living' adjustments for public-sector salaries.

Only if proper discipline is maintained can existing budgets be redirected towards those not cushioned by property or other private wealth, and in particular to the younger generation that has faced so many difficulties. The resurgence of NEETs needs urgent attention, including better mental health support and more education and training for young people. And more support should be given to those charting routes out of private rentals, including a Starter Deposit equity loan scheme, which could provide first-time buyers with a 5 per cent deposit on a starter home.

The Government must reset from a position of honesty and with a clear sense of priority

So there are many ways for policy to drive faster growth and stronger living standards, particularly for those who have had the hardest few years. The policies we set out here are clearly on the side of growth, work and the young, but are also realistic about the constraints of the public finances, calling for ambitious and coherent tax reform. Fiscal restraint also means making choices within the welfare system to support the poorest without increasing the bill, and ensuring public services spending delivers better value for money. Because living standards must be a top priority, ruthless prioritisation is needed. None of this will be easy. But the only remaining viable strategy is facing, then fixing, the state we find ourselves in.

Marooned at mid-term, the Government must face the realities of Britain's problems

Honesty, they say, must be the starting point for repairing any relationship. As the Government contemplates patching things up with voters who have turned against it, the indispensable precondition is an honest assessment of where the country stands. The sourness of the current mood traces directly back to the evasions which emanated from all sides in the last General Election campaign. Ahead of polling day, the outgoing Government unveiled palpably unsustainable National Insurance cuts. To compound that, the incoming Labour Government insisted that it could transform growth and repair public services and would not "reach for the tax lever". In the event, as shown in Figure 1, that lever was yanked, and yanked hard. Annual tax increases since the election total nearly £70 billion by end of the decade. Refuge was sought in an inherited "black hole", but this scarcely contained the political damage. Meanwhile, despite committing more than £80 billion in annual spending, public services have not yet improved.[1] So, if the Government wants to reset its failing agenda, this time must be different. It should start from a place of honesty – with a clear-eyed assessment of the challenges we face.

FIGURE 1: **Since the election the government has borrowed more, spent more and taxed more**

Change in public sector net borrowing as a result of policies announced in this Parliament: UK

NOTES: Welfare includes savings from reduced DWP fraud and error, as scored by the OBR in October 2024.
SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, various.

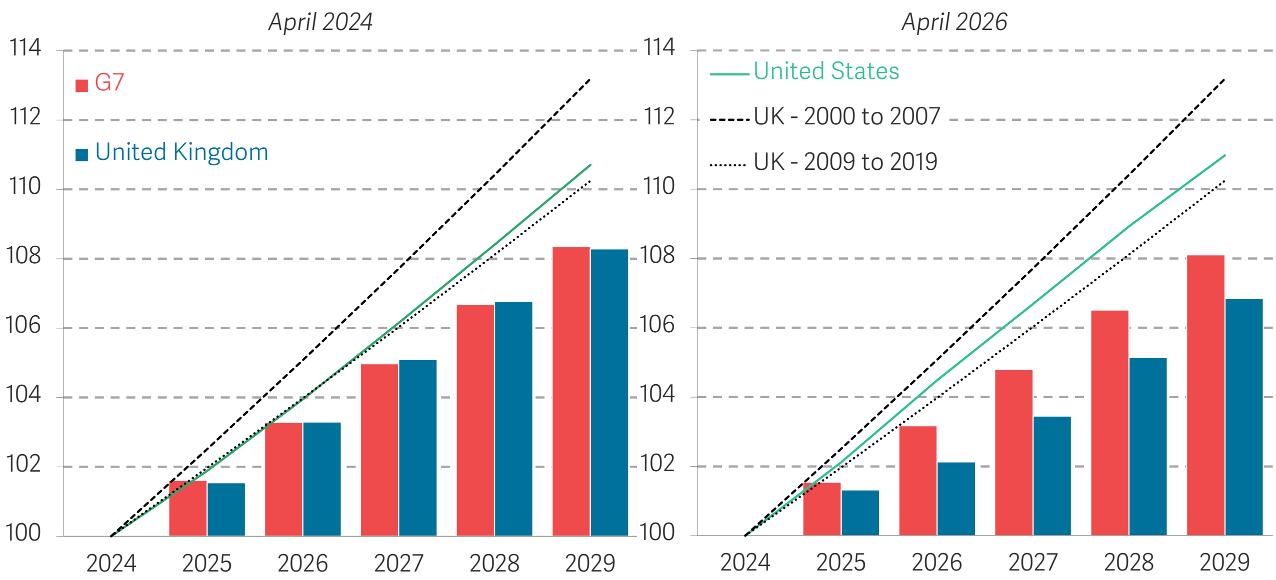
1 Institute for Government, Public services performance tracker 2025: Cross-service analysis, November 2025.

The growth fairy has been as mythical as ever

The most important shortcoming for families and for their living standards is that the outlook for growth has certainly not – or at least not yet – been transformed. Figure 2 shows two forecasts for UK GDP through to 2029 – one from April 2024 and the second from April 2026. In both forecasts UK growth clearly lags the path of progress expected in the US. Indeed, we can see that the British economy is advancing less rapidly than it did during the difficult decade of recovery from the Great Recession (between 2009 and 2019), let alone during its more buoyant days before the financial crisis. And the outlook for UK growth has not just remained historically weak – it is now weaker than was expected before the election. Figure 2 shows that the IMF's assessment of UK growth over this Parliament has been marked down since before the election (from 8.3 per cent to 6.8 per cent between 2024 and 2029), and now sits even further below both historical norms and the G7 average. The US experience shows that this is not inevitable. In the long run, growth per person is one of the most important determinants of living standards, and that too is running below historic trends. In the decade after the financial crisis the average growth rate of real GDP per person ran at 1.4 per cent, while the OBR's March 2026 forecast had the average from 2024-25 to 2029-30 at only 1.1 per cent.[2]

FIGURE 2: **Hoped for stronger growth has not materialised since the election**

Index of real GDP, by country (2024 = 100): G7 and UK, 2024 to 2029



NOTES: The UK trend lines are calculated from 2000 to 2007, and 2009 to 2019.
SOURCE: IMF, World Economic Outlook, various.

2 Source: RF analysis of OBR, Economic and Fiscal Outlook, March 2026.

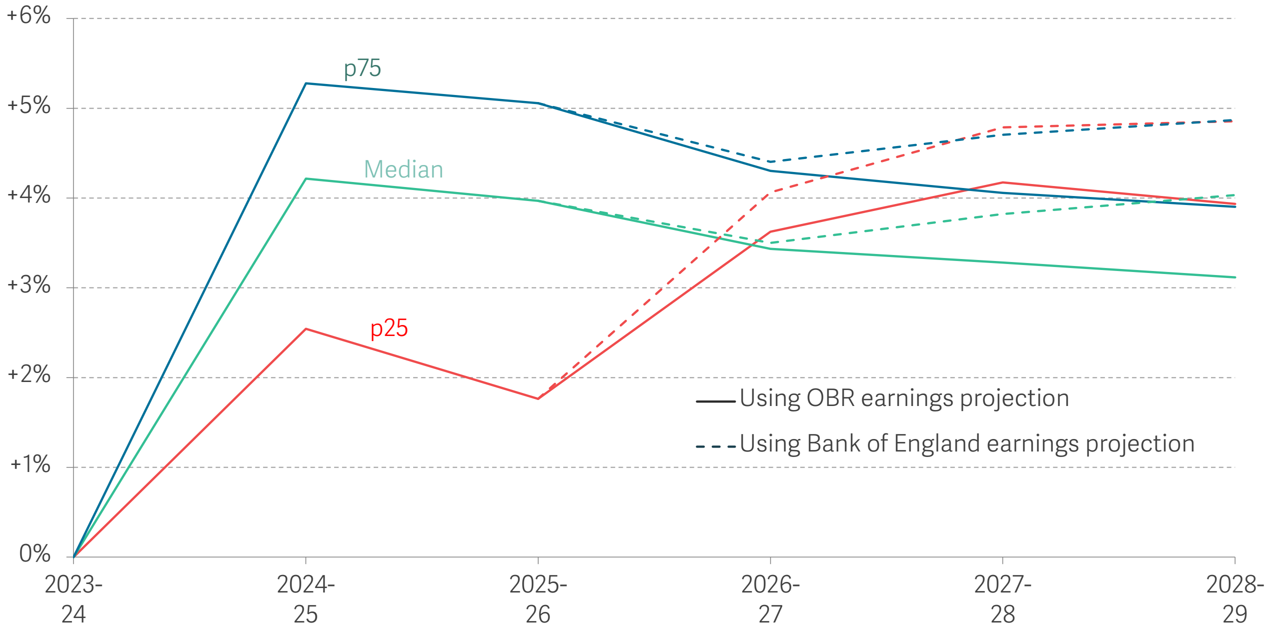
The war in the Middle East threatens to sink us into outright stagnation, with yet more dark implications for growth and the cost of living. In response to the war, the IMF marked down its forecast for UK growth over the next two years by 0.7 percentage points – the largest such downgrade among G7 countries, reflected in the April 2026 forecast above.

It's not unusual for governments to bank on beating forecasts while kicking cans down the road. But as an unstable world continues to deliver more negative shocks than positive ones, conditions in the bond market also suggest that road may have run out. Britain has balanced the books just once in the past quarter of a century. And if we have now reached a point where investors' tolerance for this failure is nearing its end, then the result will be higher volatility, increased uncertainty and ultimately higher interest rates all of which delivers another unwelcome headwind to growth.

Growth isn't the only driver of living standards, but over the long run it is the dominant factor – because sustained wage growth depends on it. Figure 3 shows our projections for household income growth this Parliament at three points in the income distribution. Under our central pre-war projection – which uses the OBR's March 2026 forecast of 4.4 per cent nominal average earnings growth between 2026-27 and 2028-29 – the median household income would grow by 3.1 per cent across the Parliament. Using the Bank of England's more optimistic scenario of 5.3 per cent earnings growth between 2026-27 and 2028-29, it would instead grow by 4.0 per cent – a difference worth £280 per year.

FIGURE 3: **Higher growth is the key to boosting wages and living standards**

Projected cumulative change from 2023-24 in equivalised after housing costs disposable household income, non-pensioners: UK

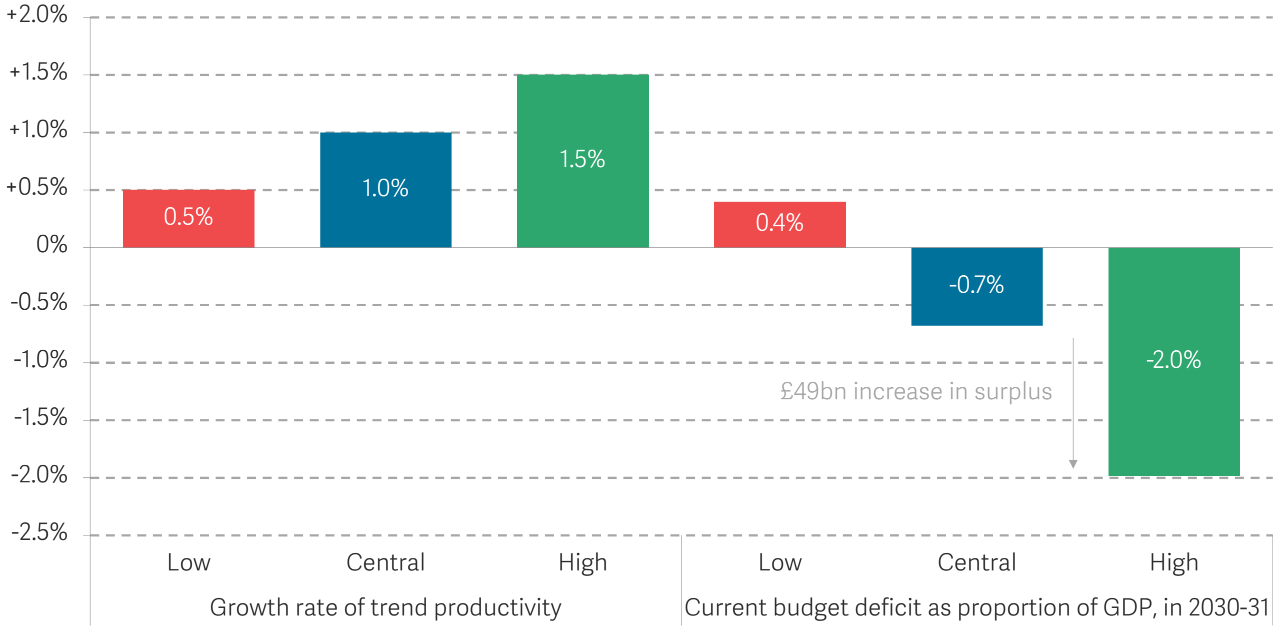


NOTES: OBR earnings growth projection from the March 2026 Economic and Fiscal Outlook. Bank of England projection is Scenario A from the April 2026 Monetary Policy Report. Incomes deflated differentially by decile of equivalised household income using ONS, Household Costs Indices. Incomes from 2026-27 onwards are deflated using the Bank of England's short-term inflation forecast from its most recent Monetary Policy Report for petrol, household energy bills and food. Prices are held fixed beyond the horizon of the short-term inflation forecast, meaning that this approach will underestimate the impact of food prices which take longer to adjust. The differential inflation effect is estimated using the weights and methodology underlying the ONS's Household Cost Indices.
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; OBR, Economic and Fiscal Outlook, March 2026; Bank of England, Monetary Policy Report, April 2026.

So growth is crucial for living standards. And the thorny fiscal choices confronting the Government will only get harder the longer the economy is left to drift. Figure 4 shows that achieving a 0.7 per cent of GDP current budget surplus in 2030-31 relies on annual productivity growth in line with the OBR's trend assumption of roughly 1 per cent. That surplus – or rather, that plan for a surplus – represents the total of Rachel Reeves' room for manoeuvre, or 'headroom', against her fiscal rules. A halving of annual productivity growth, to 0.5 per cent, would more than exhaust it and saddle Britain with a stubborn current budget deficit, which would need fresh tax rises or spending cuts to close. Any picking up of the pace, by contrast, would greatly expand the range of options. Restoring productivity growth to 1.5 per cent – still unexciting by historical standards – would more than double the projected current surplus, pushing it up from 0.7 to 2.0 per cent of GDP and providing an extra buffer of £49 billion. Deciding whether to use that to lower debt, the tax burden, or boost public services would be a much easier political choice than the one currently facing Ministers.

FIGURE 4: **The difference growth makes: Higher productivity could turn Britain's deficits into surpluses**

Three scenarios for trend productivity and respective projected current budget deficit as proportions of GDP in 2030-31: UK



NOTES: The OBR assumes that a change to productivity drives an equivalent change in nominal GDP. This is distributed uniformly across the main expenditure and income components. There are no offsetting impacts elsewhere in the forecast. In the lower productivity scenario, trend productivity growth remains at 0.5 per cent per year throughout the forecast. In the higher productivity scenario, trend productivity growth averages 1.2 per cent per year and reaches 1.5 per cent in 2030-31.
SOURCE: OBR, Economic and Fiscal Outlook, November 2025.

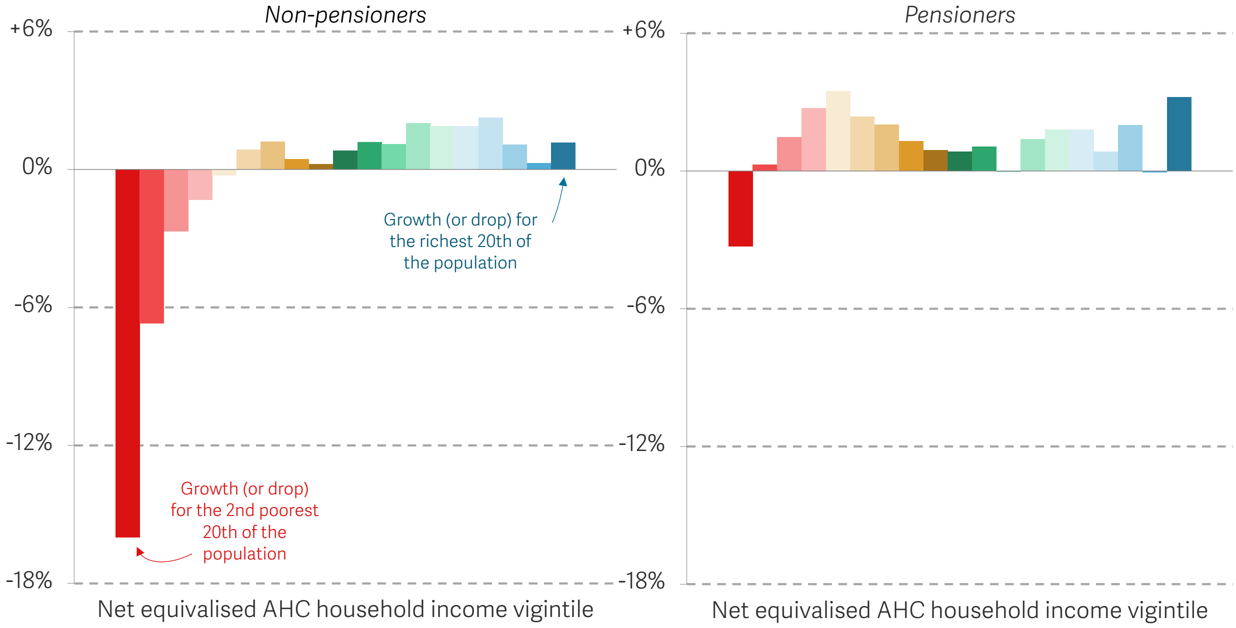
These figures show the importance of growth, but do not show realistic outcomes for government growth policy in the short term. No feasible growth policy can reliably raise productivity to such an extent across a mature and medium-sized economy in a few years. And even if growth were to materialise, it is not a panacea: to pick one example, the wages of public sector workers will tend to need to rise in line with those in the private sector in the medium term in order to recruit and retain, exhausting some of the fiscal gains. Growth is critical for living standards, but no Government can rely on it arriving quickly – nor mistake it for a way of dodging the fiscal dilemmas ahead.

Another blow to living standards of poorer working-age families

Anaemic growth means disappointing progress on living standards. That is the first and most important consequence of a sluggish economy. For working-age households the past few years have been grim: a long period of stagnation since the financial crisis was followed by the struggles of the cost of living crisis that came hot on the heels of the pandemic. Figure 5 shows the change in real incomes across the income distribution between 2021-22 and 2025-26, deflating by differential inflation to account for the fact that price rises hit poorer and richer households differently. The post-pandemic bounce back in incomes was meagre across most working-age households: average annual growth in typical incomes between 2021-22 and 2025-26 was just 0.2 per cent, compared to an annual average of 1.3 per cent for the 20 years before the pandemic. For poorer families, annual incomes have actually sunk, on average, since the end of the pandemic, and truly plunged at the very bottom, where the proportional fall of 16.0 per cent cashes in at almost £1,800. This is in part due to the September 2021 removal of the £20 per week uplift to Universal Credit introduced to protect poorer families during the pandemic. The financial year that started in April 2026 kicked off with some sorely needed relief for many of the hardest-pressed – thanks to a small, above-the-board increase in Universal Credit and (especially) the end of the two-child limit for large families. Yet after the past few years, poorer working-age families are inevitably still feeling left behind.

FIGURE 5: **Living standards for lower-income households were especially hard hit in the last few years...**

Projected real-terms change in after housing cost incomes between 2021-22 and 2025-26, by income vigintile: UK



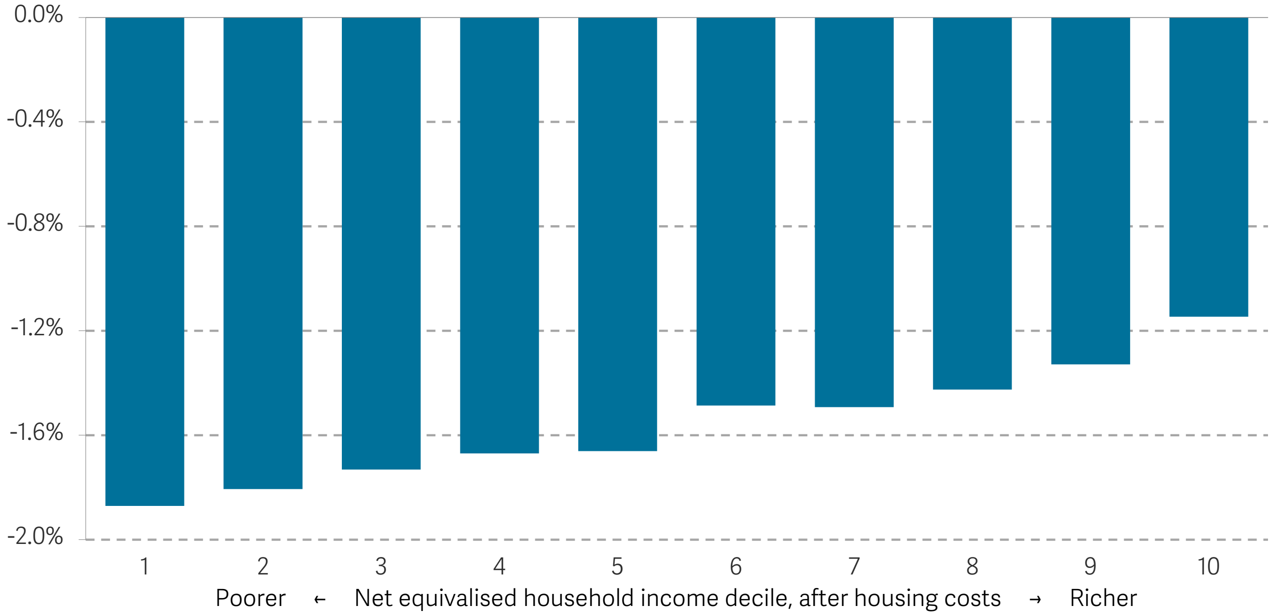
NOTES: Incomes after 2023-24 are projected. Incomes deflated differentially by decile of equivalised household income using ONS, Household Costs Indices. The bottom 5 per cent are excluded due to concerns about the reliability of data for this group.
SOURCE: RF analysis of DWP, Family Resources Survey using the IPPR tax-benefit model; ONS, Household Costs Indices; OBR, Economic and Fiscal Outlook, March 2026; Bank of England, Monetary Policy Report, April 2026.

Looking ahead, higher utility and petrol prices driven by the war in the Middle East threaten yet another big squeeze on households' budgets. Based on the Bank of England's most optimistic scenario for the war, inflation will rise to 3.6 per cent by the end of the year, draining away the progress that would otherwise have been enjoyed in a relatively benign 2026-27.[3] The typical working-age household, who was previously on track for 1.2 per cent income growth this year, is now set to see its income fall by 0.5 per cent – a difference of £550 over the course of the current financial year. Even for the bottom fifth, where lower-income households are due to receive those long-overdue real-terms increase in their benefits mentioned above, we now estimate that average income growth will be almost halved from the expected 3.8 per cent, to just 2.0 per cent.

And the economic impact of the war will not impact all households equally. Figure 6 shows how this expected inflation shock will hit poorer households proportionately harder than richer households. The income of households in the bottom decile will be 1.9 per cent lower this year than they were set to be before the war, while households in the richest decile will only see a 1.1 per cent hit. This is because a greater proportion of poorer households' incomes are spent on areas that are more exposed to an oil price shock, such as food and utility bills.

FIGURE 6: **...and now another slanted squeeze is in prospect**

Projected real-terms change in after housing cost incomes of non-pensioners due to the Iran war inflation shock, by income decile: 2026-27



NOTES: Chart shows the percentage difference in equivalised household income due to the rise in inflation shock arising from the conflict in the Middle East. That impact is estimated by using the Bank of England's short-term inflation forecast from its most recent Monetary Policy Report for petrol, household energy bills and food. Prices are held fixed beyond the horizon of the short-term inflation forecast, meaning that this approach will underestimate the impact of food prices which take longer to adjust. The differential inflation effect is estimated using the weights and methodology underlying the ONS's Household Cost Indices.
SOURCE: RF analysis of DWP, Family Resources Survey using the IPPR tax-benefit model; ONS, Household Costs Indices; OBR, Economic and Fiscal Outlook, March 2026; Bank of England, Monetary Policy Report, April 2026.

3 Bank of England, Monetary Policy Report, April 2026.

So the living standards misery has continued, but not all families have struggled to the same extent as poorer families have been hit hardest since the cost of living crisis. Meanwhile, pensioners fared better, albeit still at rates that are low by historical standards (see Figure 5): median pensioner incomes grew 1.0 per cent between 2021-22 and 2025-26, while the incomes of those at the 25th percentile grew by 3.1 per cent. This is part of a wider picture in which those with significant household wealth have fared better. The richest 10 per cent receive 28 per cent of the country's income, while the wealthiest 10 per cent own half of the country's wealth. At the same time, 40 per cent of the £5.9 trillion increase in household wealth (between 2006-08 and 2018-20) went to those in their late 50's and early 60's.[4] The rising importance of wealth matters.[5] It dampens social mobility and means that more of life's outcomes are determined by who your parents are, rather than individual ability. Even if a typical person in the fifth wealth decile miraculously saved all their earnings throughout their entire working life, it would no longer be enough to move them up to the top of Britain's wealth ladder.[6]

The public finances are in dire need of repair

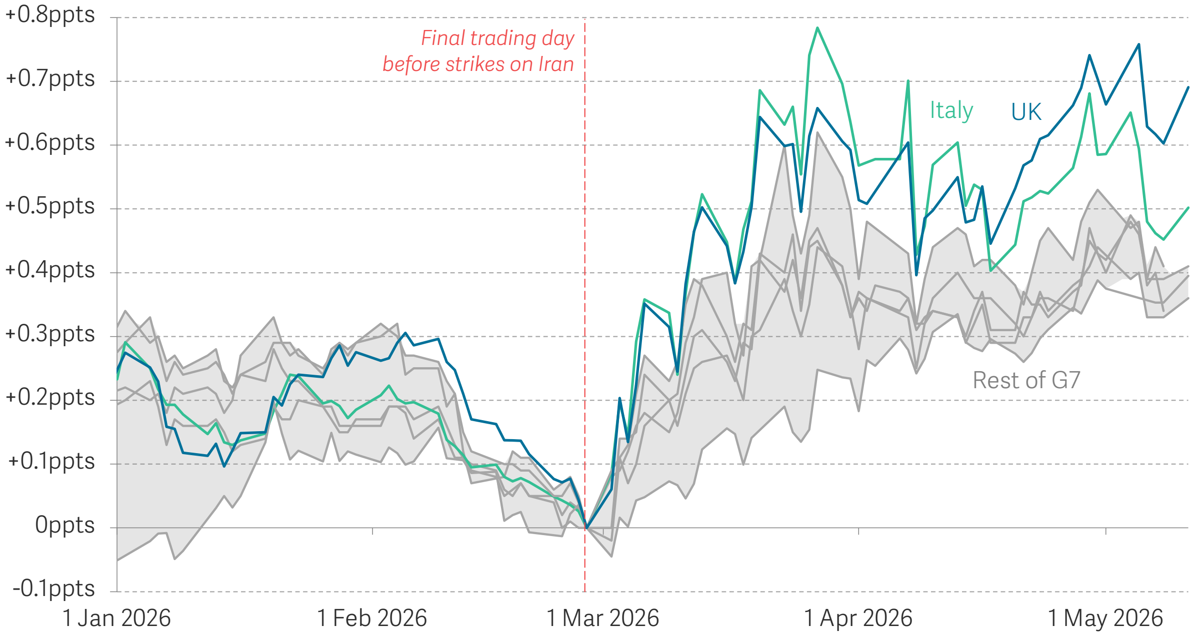
Nowhere is the lack of an honest conversation about the country's problems more pervasive than around our beleaguered public finances. Pretending that we can repair broken public services while borrowing less and not raising taxes might make for an effective campaign strategy. But as a basis for government, it has run out of road.

As shown in Figure 7, markets have been demanding a higher return to lend to governments since the American-Israeli assault on Iran began at the end of February. This has happened across the G7, but the rise has been more marked for some governments than others. The UK (alongside Italy) is now dealing with considerably more expensive borrowing costs than the rest of the pack. The uncertainty surrounding the future of our public finances comes with a very real cost in the form of higher debt-servicing costs and illustrates the constraints that any Government must work within, and which can't be wished away.

4 M Broome et al., An intergenerational audit for the UK: 2023, Resolution Foundation, November 2023.
5 R Curtice, The Resolution Foundation at 20: Two decades of analysis, policy and change, Resolution Foundation, September 2025, https://doi.org/10.63492/yjk797.
6 M Broome & R Kanabar, Before the fall: The distribution of household wealth in Britain and the impact on families, Resolution Foundation, October 2025, https://doi.org/10.63492/pcv793.

FIGURE 7: **The war has pushed up borrowing costs for the UK by more than the rest of the G7**

Change in 10-year bond yields around the start of the conflict in the Middle East: G7 countries

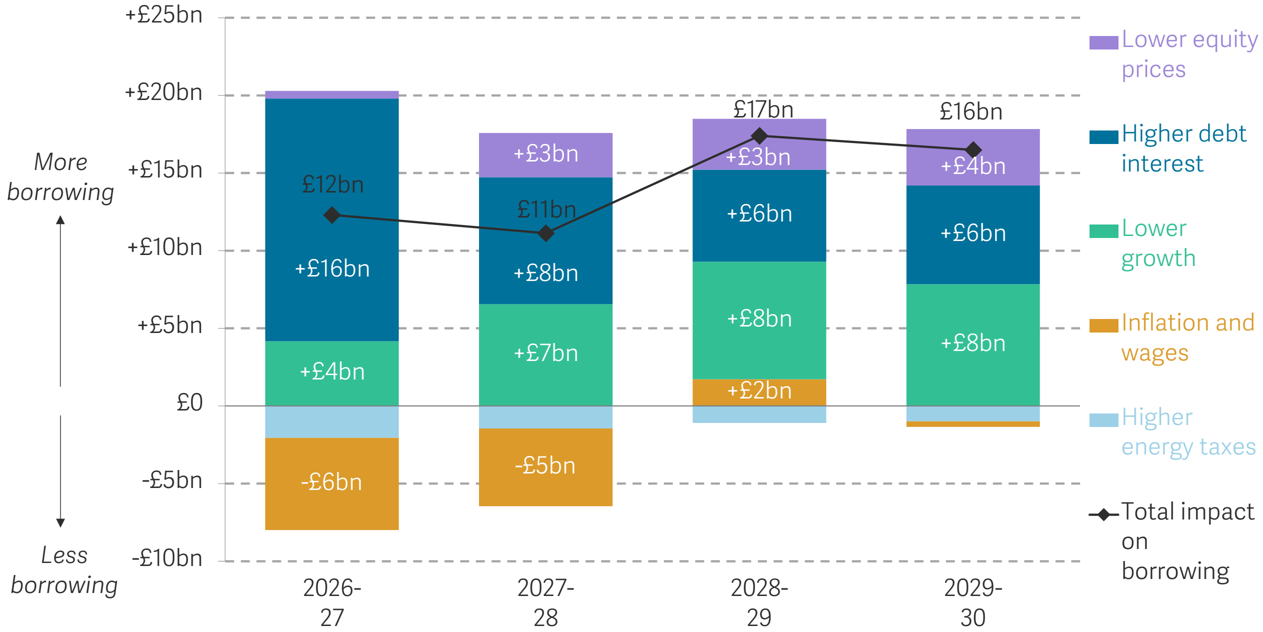


NOTES: End-of-day data up to Monday 11 May 2026. Yields are a mix of observed benchmark bond yields and yields interpolated from fitted yield curves, depending on data availability.
SOURCE: RF analysis of various national authorities' data; investing.com.

This newly pricey borrowing raises the cost of servicing our debt. Debt interest already consumes more spending than any public service bar the NHS. But as the economic fallout continues to radiate out from the Middle East, other fiscal effects will eventually also do damage. Figure 8 draws on the Bank of England's middle scenario for the impact of the war, and shows how the hit to revenue from slower growth, alongside the impact of recent moves in asset prices, will push borrowing higher. The likely boons for the Exchequer from taxing energy and inflation (which helps fill the government's coffers at the same time as it hurts households) look decidedly modest by contrast. All told, an expected £16 billion on borrowing by 2029-30 would wipe out much of the £24 billion margin for error that the Chancellor left herself against her fiscal rules at this year's Spring Forecast. Such a hit to borrowing in three-years' time is comparable to the roughly £18 billion deterioration in year three borrowing recorded at the November 2016 Autumn Statement – the first OBR forecast after the Brexit referendum. It's to the Chancellor's credit that she has put in place a buffer that could withstand such a hit to the public finances.

FIGURE 8: **A triple whammy for the Treasury from the war: costlier borrowing, slower growth and lower asset prices**

Estimated changes to the OBR forecast for public sector net borrowing since the Spring Forecast, based on changes implied by the Bank of England's middle scenario for the impact of war in the Middle East: UK

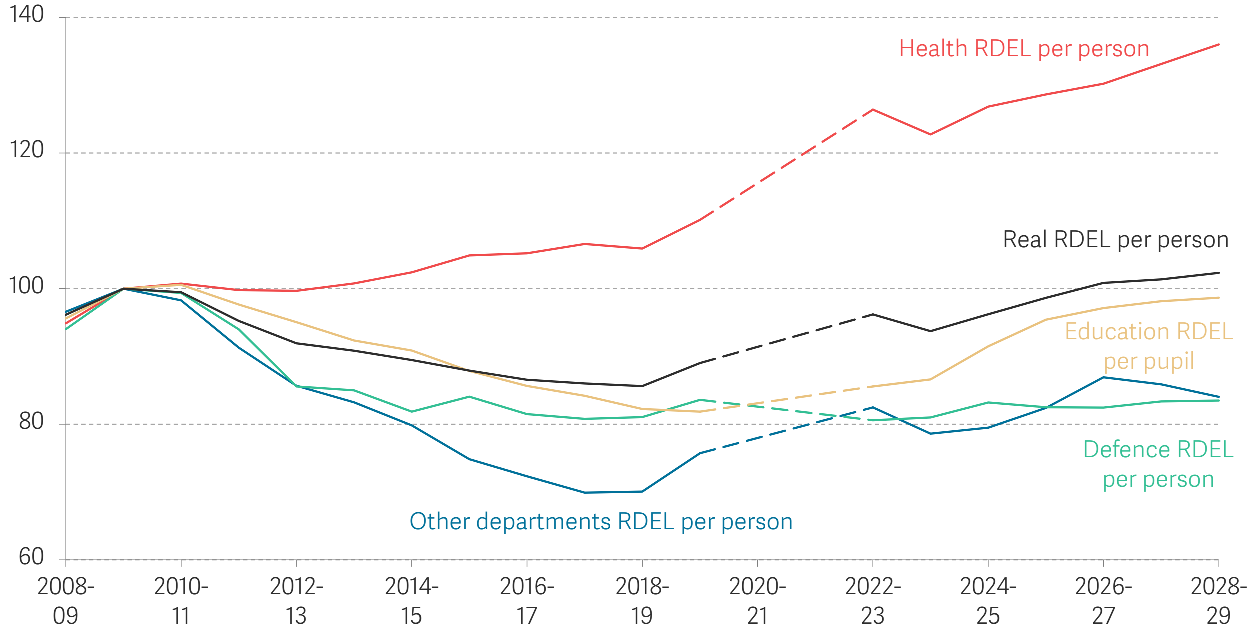


NOTES: Chart shows the impact on borrowing of current falls in asset prices (to 8 May 2026) combined with the impact of growth, inflation and wage forecasts taken from the Bank of England's 'Scenario B' (the Bank's middle scenario for the impact of the war in the Middle East) contained in its April 2026 Monetary Policy Report.
SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, various; and Bank of England, Monetary Policy Report, April 2026.

Day-to-day departmental spending increased in real terms through the pandemic and received a further significant boost at the start of this Parliament. As shown in Figure 9, plans set out in last year's Spending Review imply that the resources going to education – and particularly to health – are rising over the coming years, even after accounting for population growth and inflation. Elsewhere spending is set to fall but will still end the spending review period higher than it was at the start of the Parliament. Overall, day to day spending on public services in 2028-29 is set to be 2.3 per cent higher per person in real terms than in 2010 before the austerity period, albeit with a significant shift towards health over other areas of spending. And yet the backdrop is a sense that the country's public services are broken and this in itself is damaging people's quality of life. The primary challenge of the next few years is to deliver much better-quality public services within these not ungenerous envelopes.

FIGURE 9: **Big increases in public spending were front-loaded in this Parliament**

Indices of real per-person resource departmental expenditure limits (2009-10 = 100), by selected departments and other departments over the 2025 Spending Review period



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

Matters are made worse by the growing consensus that more needs to be spent on our national security in an increasingly fractured world. For more than half a century since the Korean War, a near-continuous squeeze on defence's share in the economy helped governments of all stripes make the rest of their plans add up. More recently, defence spending has flatlined at an historically low level (Figure 9). But today, many across the political spectrum see a pressing need to raise defence spending in a more polarised and contested world. Despite being criticised for a lack of detail and timetable, Keir Starmer has in principle signed up to the new NATO target of defence spending of 3.5 per cent of GDP plus an additional 1.5 per cent spent on wider defence infrastructure by 2035.[7] This would represent a substantial change from the average spend of just 2.2 per cent of GDP over the past three decades, as shown in Figure 10. The current spending review has defence spending rising to £74 billion by 2028-29.[8] Ramping up spending to 3 per cent by the end of this Parliament – something that the Prime Minister has suggested he is prepared to do on the way to 3.5 per cent – would require finding an extra £13 billion for day-to-day spending.

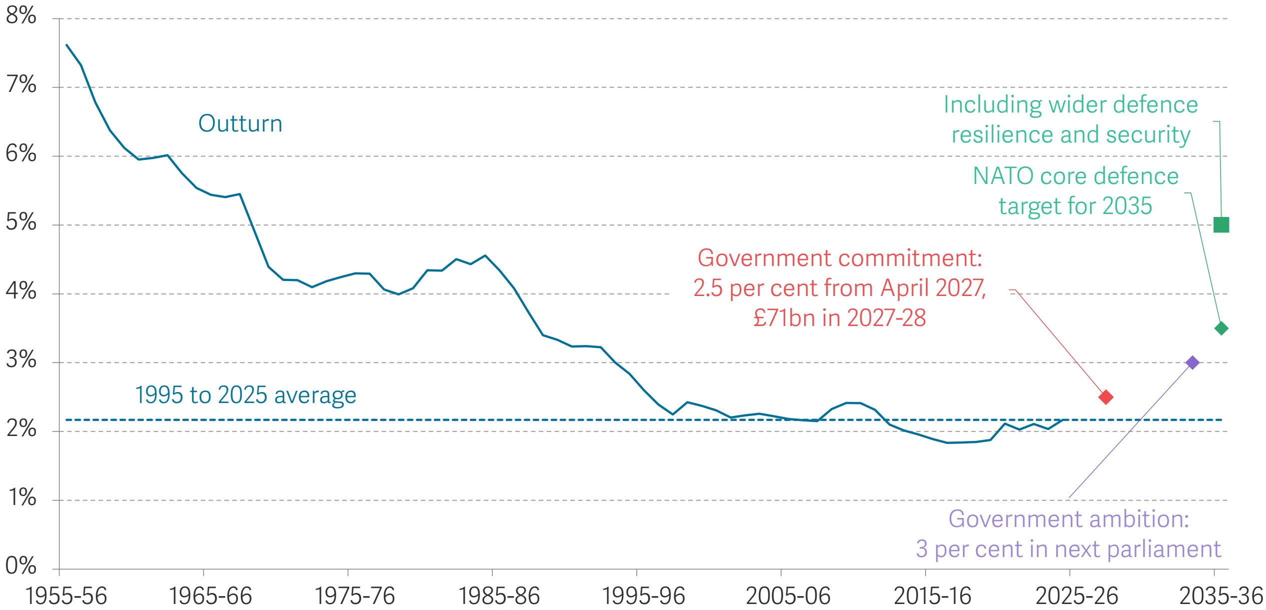
Some suggest that borrowing for defence can and should be treated differently from borrowing for schools and hospitals. War has often inspired fiscal innovation – from the creation of income tax to fight Napoleon to the issuance of war bonds in 1914. The

7 Prime Minister's Office, UK to deliver on 5% NATO pledge as Government drives greater security for working people, 23 June 2025.
8 HM Treasury, Supporting documents for Spending Review 2025, June 2025.

temporary exigencies of battle are indeed a stronger reason to borrow than most. But in the face of an open-ended raising of the geopolitical threat, what's really envisaged is an increase in resourcing that will last into the foreseeable future. A permanent increase in spending, whatever it is on, will have to come from somewhere in the end and, in this sense, defence is no different from any other kind of spending.

FIGURE 10: **The British state traditionally paid its way by squeezing defence – but now there is a growing consensus that spending needs to rise**

Defence spending as share of UK GDP, 1955-56 to 2035-36

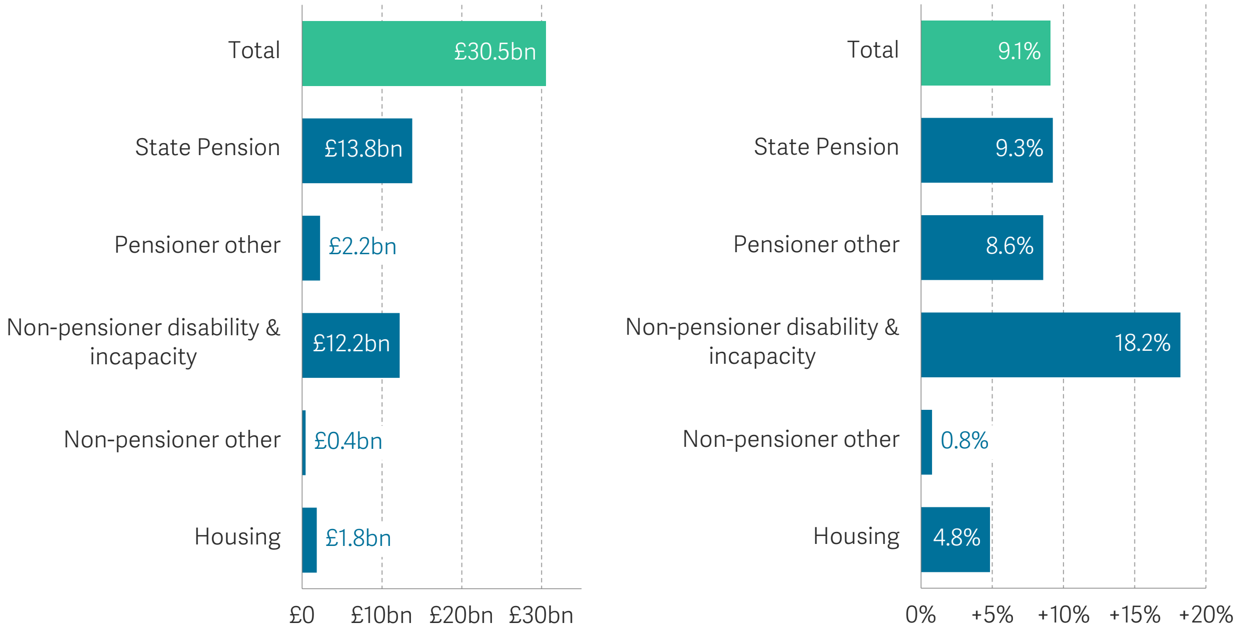


NOTES: Outturn spending figures up to 2019-20 based on IFS TaxLab data, then up to 2024-25 HM Treasury PESA data. 2033-34 chosen for the year to indicate the government ambition 'in the next parliament'.
SOURCES: IFS, TaxLab spending composition; HM Treasury, Public Expenditure Statistical Analyses, December 2025; OBR, Public finances databank, March 2026; HM Treasury, Spending Review 2025 documents.

The country also faces sharp trade-offs when it comes to social security. Adjusting for inflation, the amount we spend in this area is rising from £336 billion in 2025-26 to £366 billion by the end of the decade (2026-27 prices). While a significant sum, welfare spending is expected to remain flat at 11.1 per cent of GDP between now and 2029-30, still below 2012-13 peaks of 12.0 per cent. As shown Figure 11, the epicentre of rising spending comes in the form of higher pension- and health-related benefit spending. Given the weak living standards picture mentioned above, particularly for lower-income families, it's certainly possible to make the case that such spending should be prioritised. Despite this, the weak position of the public finances makes it imperative to address the areas where spending is rising fastest.

FIGURE 11: **Spending on pensions and health-related benefits is rising**

Forecast change in real-terms social security expenditure by category, 2025-26 to 2029-30, in cash terms (left panel) and as a proportion of total spending (right panel): GB



NOTES: 2026-27 prices, deflated by GDP.
SOURCE: RF analysis of DWP, Spring Forecast 2026 Expenditure and Caseload forecasts; Scottish Fiscal Commission, Economic & Fiscal Forecasts, various.

The language of priorities: growth for all, and a rebalancing for the most squeezed

No leader or government can navigate a way forward without making some serious choices, choices that can't please everybody. What would a policy agenda focused on improving living standards focus on? First, the Government should avoid distractions and double down on its commitment to growth. Second, it should also rebalance policy towards younger, working families and away from the advantages enjoyed by older, wealthier people.

In light of the fiscal position, such rebalancing is – unfortunately – in the first instance going to be less concerned with giveaways than difficult decisions about ruthlessly prioritising spending, and identifying additional revenues. We will provide concrete examples of both. Few of the suggestions we make would be classed as 'easy wins': many will face opposition. But especially in combination, they could start to make a real difference.

Doubling down on growth

The Government stood in 2024 on a promise to get the economy growing. It was right to do so. As we have shown, higher growth is the key to raising living standards. Sadly, despite some green shoots, we are yet to see a sustained or general improvement.[9]

9 E Christensen et al., Mountain climbing: Making progress on the UK's growth policy challenge, Resolution Foundation, January 2026, https://doi.org/10.63492/ntdl6708.

This is not because there have been no improvements to policy. Reforming the fiscal framework to reverse inherited cuts to public investment was bold. Positive, too, have been various measures to boost private investment, including pension fund reforms, new Trade and Industrial Strategies and honouring a promise of a stable Corporation Tax regime. Alongside this, the Government has pursued supply-side reforms, including on regulation – with a particular focus on planning, where businesses report the greatest regulatory complexity – and skills provision.

But positively shifting the growth rate of a medium sized advanced economy requires the Government to do an awful lot of good things, and keep doing them over a very long time. Progress has been too slow and too timid given the vast scale of the challenge, which energy and other shocks continue to complicate.

So what, concretely, would it mean truly to 'double down' on growth?

Trade is one area where delivery has undershot ambition. Yes, there has been some progress in the form of new agreements, particularly with the US and India, as well as efforts to smooth some of the roughest edges created by the UK's hard Brexit deal. But there is much more to do, particularly on the UK's relationship with the EU, where closer integration could deliver material gains – most obviously in the form of the single market for goods, where Brexit has most damaged trade. Failure to pursue this seems inconsistent with the Government's claim that it is serious about making up some of the growth hit from Brexit which now looks like it could turn out to be close to double the 4 per cent impact initially assumed by the OBR.[10]

If this sort of deeper EU integration is still deemed politically out of reach, the Government desperately needs to find other ways to steer the economy closer to the giant European market. For a sector like pharmaceuticals and chemicals the notional freedom to write our own rules is, in practice, a freedom to do nothing but make ourselves poorer. The case for keeping standards in automatic lockstep with our largest export market – so called 'dynamic alignment' – is a trade off that would be well worth making.[11]

Elsewhere, doubling down on growth will mean making some hard strategic decisions, including about the geographical concentration of effort. There are inevitably limits on the public resources available for investment in things like transport, social housing and regeneration, and also – more subtly – restrictions on the bandwidth that the national authorities have to engage with problems in local economies. In previous work we

10 N Bloom et al., The Economic Impact of Brexit, NBER Working Paper No. 34459, November 2025, https://doi.org/10.3386/w34459.
11 For more detail on the priority sectors for alignment with the EU, as well the case for more agile regulation elsewhere, see: E Christensen et al., Mountain climbing: Making progress on the UK's growth policy challenge, Resolution Foundation, January 2026, https://doi.org/10.63492/ntdl6708.

have called for a particular concentration of resources and effort on Manchester and Birmingham city regions, conurbations that currently lag far behind London, but have the scale to deliver London-style agglomeration benefits.[12] We have also proposed deepening fiscal devolution to city regions, where local authorities have the close view of their own economies needed to strike the right balance between taxes and public investment to meet local needs.

A serious growth policy also requires a willingness to confront vested interests. Planning is one area where the Government has at times seemed up for such a fight, following up on its vow to back the 'builders' over the 'blockers' with legislative reforms and stretching new local housing targets. Even so, as things stand housing starts across the UK have barely budged since the Government took power.[13] To reverse this, the Government needs a London-specific 'delivery package' alongside national planning reform, most obviously by streamlining the functions of the new Building Safety Regulator. The Government should also address capacity issues in the planning system, support greater densification in urban and well-connected areas, reduce avoidable regulatory costs and accelerate the delivery of up-to-date local plans. There also needs to be a more proactive role for the public sector with funding to match. This should include establishing development corporations with the firepower to build a new generation of new towns.

With public borrowing high and costly, there should be a particular premium on identifying tax reforms which can both bolster the potential for long-term growth and bring in revenue to deal with more immediate problems. We can offer several such reforms. Lowering the turnover threshold at which small companies are required to register for VAT, from £90,000 to £30,000, would not just raise £2 billion annually by 2029-30, but also take on the trap whereby small firms hold down turnover to remain below the threshold.[14] The economy as a whole, as well as individual businesses, will tend to expand when such barriers to 'scale-up' are removed. Other revenue-raising measures that we consider below principally because they allow for more equal treatment – between income from different sources, or in different structures – will also remove perverse incentives regarding the way economic activity is arranged, and as such should also boost growth.

Britain cannot sustain faster growth without a material increase in private-sector investment. This is why recent governments have moved towards 'full expensing', allowing capital investment to be fully deducted from Corporation Tax in the year of expenditure. There is still scope, though, to broaden what qualifies as tax-deductible

12 Resolution Foundation & Centre for Economic Performance, LSE, Ending Stagnation: A New Economic Strategy for Britain, Resolution Foundation, December 2023.
13 Source: ONS, Indicators of house building, UK: permanent dwellings started and completed by country, April 2026.
14 A Corlett, Call of duties: Revenue and reform for Autumn Budget 2025, Resolution Foundation, September 2025, https://doi.org/10.63492/rc611.

corporate expenditure here – in particular, there is a powerful case for extending further to a broader range of technology-related assets, including intangibles.[15] This won't come cheap, however. The cost of the original, temporary full expensing policy was as high as £27 billion in the short-term as investment spending was brought forward, with this cost declining over the forecast period.[16]

But getting serious about growth also means taking on those taxes that frustrate it. The most obvious area here relates to property taxes. As things stand, too many of the levies impede productive activity and dynamism. Some can be reformed in a revenue neutral way. Business rates, for example, could usefully be recast on the basis of the value of land, as exempting commercial structures would encourage firms to build and modernise. Stamp Duty Land Tax, meanwhile, puts sand in the wheels of companies expanding or moving, and raises the cost for workers moving home to secure better employment.[17] The ambition should be to reduce it, in pursuit of greater economic dynamism.

As we have stressed throughout, however, Britain in 2026 is not living in anything like an ideal world. This cash-strapped Government cannot afford to do without the near £17 billion in receipts which the combined duties on commercial and residential property trades brought into the public coffers in 2025.[18] Even if abolition were affordable, it would – in isolation – have some perverse effects, pushing up property prices as the buyers who would no longer be liable for it responded by making higher bids. The upshot would be a significant windfall gain for established property owners, when analysis of living standards suggests that it is renters, younger cohorts and others who own little that need to be given priority today. If a commitment to growth means considering costly reductions in Stamp Duty, a commitment to improving squeezed living standards means looking elsewhere to ensure that property – and wealth held in other forms – continues to pay its way.

A better-balanced economy: wealth before work, and giving the young equal weight with the old

As we have shown, the recent history of living standards has been disappointing across the board – notably worse for working age families than for pensioners, and worst of all for the poorest among them. Those who grew up in the shadow of the financial crisis have also had a particularly testing time, including adverse trends in the labour

15 S Pittaway, Yanked away: Accounting for the post-pandemic productivity divergence between Britain and America, Resolution Foundation, April 2025, https://doi.org/10.63492/DMXN5237.
16 The £27 billion figure reflects the Exchequer impact in the three years from 2023-24 to 2025-26 for the March 2023 temporary measure. HM Treasury, Spring Budget 2023 Policy Costings, March 2023.
17 Stamp Duty Land Tax is in operation in England and Northern Ireland. Land and building transaction tax is in operation in Scotland and Land transaction tax in Wales. All these property transaction taxes are fairly similar in design, where the tax is paid by the purchaser when a property is bought. The ONS combine them when recording tax receipts in the public finance statistics.
18 Source: ONS, Current receipts: Taxes on production: Stamp duty (land and property), April 2026.

market, a concentrated rise in mental health problems and historically low rates of homeownership.[19] Likewise, when rent eats a huge hole into the disposable incomes of so many private tenants, a living standards focus suggests they deserve some prioritisation over owners.

With this in mind, we now turn our attention to how this prioritisation could be achieved across three big fields of fiscal policy: taxation, social security and public service spending.

Tax: ensuring wealth and older cohorts pay their way

The Government has made much of its commitment to 'working people', and in important fields such as employment regulation it can claim to have delivered. It has some obvious ways to go further on similar terrain. For example, a 'Fair Pay Agreement' for social care and stronger practical enforcement of the newly extended labour market rights.[20] But the Government has not, at least not in any systematic way, shown the same consistent concern for relative rates of taxation.

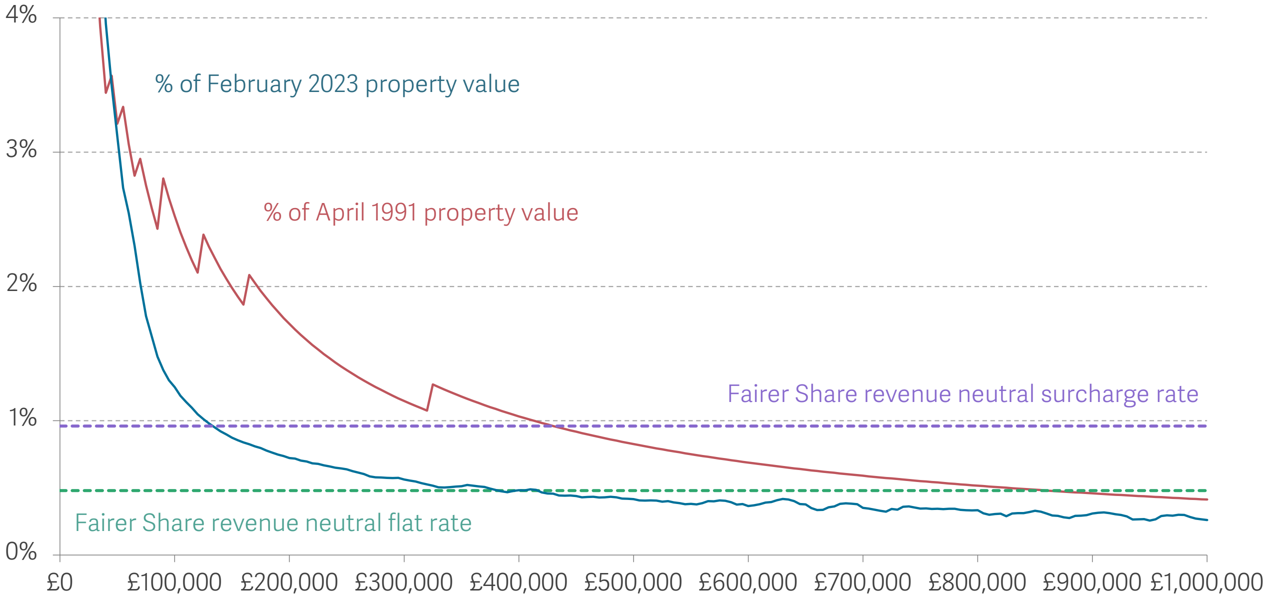
Part of the reason that the wealthy have done better is that assets remain undertaxed in Britain. Since 1980, the stock of private wealth has roughly doubled relative to the annual flow of national income – but capital taxes as a share of GDP have not kept pace with this historic shift.[21] The Wealth and Asset Survey reveals that property is the single largest component of personal wealth, making how it is taxed especially important.[22]

Aside from the growth-impeding Stamp Duty, the main charge which is imposed on residential properties is Council Tax. It has often been called a joke, but in truth it is no longer funny. It was regressive by design from the start, with a lower proportional charge on more valuable properties. But if it was flawed at the creation, it has got dramatically worse since. The old nationwide system of means-tested rebates for poorer families has been 'localised' in England, and in many places substantially pared back.[23] Bills are still calculated on frozen valuations from 1991. An awful lot has happened over the third of a century since and happened at very different speeds in different regions and even different neighbourhoods. Figure 12 underlines two things: the stubbornly regressive relationship between property values and Council Tax bills, and how effective tax rates on property have fallen as prices have risen.

19 M Broome et al., An intergenerational audit for the UK: 2023, Resolution Foundation, November 2023.
20 C McCurdy et al., Care to negotiate? Making a success of the Adult Social Care Negotiating Body, Resolution Foundation, December 2025, https://doi.org/10.63492/ykx616.
21 S Pittaway, Wealth Check, Resolution Foundation, July 2024, https://doi.org/10.63492/qmr450.
22 Office for National Statistics, Household total wealth in Great Britain: April 2020 to March 2022, January 2025.
23 A Clegg, The localisation era: Assessing the post-2013 rise in localised social security, Resolution Foundation, November 2025. https://doi.org/10.63492/ndxb35

FIGURE 12: **Council Tax always taxed bigger homes less – and the charge on properties across the range has sunk as property prices have soared**

Annual Council Tax bill as a percentage of current and 1991 property value: England



NOTES: The red line (annual Council Tax bill as a percentage of property values at 1 April 1991) is based on the average 2023-24 billing authority in England. The blue line (average Council Tax bill as a percentage of property values at 1 February 2023) is calculated by matching the average 2023-24 Council Tax bill in each region and Band to properties in Wave 12 Understanding Society, then smoothing these estimates. Property values from Understanding Society Wave 12 have been uprated to 1 February 2023 using HM Land Registry's February 2023 House Price Index.
SOURCE: Department for Levelling Up, Housing and Communities, Band D Council Tax Live Tables, March 2023; RF analysis of Wave 12 Understanding Society; Fairer Share, The Proportional Property Tax Manifesto, October 2021.

The politics of transition may be complex, and thought will need to be given to the relationship with local council funding settlements, but the appropriate direction of travel is – surely – arrestingly clear. If property values are to be taxed, then it should obviously be on their current rather than their historic value. Moreover, the tax rates charged should be (at least) proportional to value, rather than falling as prices rise. We have previously called for gradual reform guided by those simple tenets – shifting to a proportional tax based on current property values, but with rates set in each council area to raise the same revenue as today. A more gradual convergence of rates across the country could then proceed with an up-to-date tax base.[24] Others have proposed a nationwide flat rate of 0.48 per cent, as can be seen in Figure 12. Combined with a surcharge rate of 0.96 per cent on second, empty and non-resident owned, and the scrapping of SDLT for UK taxpayers with a single home, those rates would form a revenue neutral package.[25]

24 M Broome, A Corlett & G Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023.
25 A Dixon et al., The Proportional Property Tax Manifesto, Fairer Share, October 2021.

We estimate the majority of households would be better off under our proposal of locally specific rates compared to the current system. Based on one prominent proposal, 75 per cent of UK households would save through their reforms to a nationwide flat rate.[26] Implementing a proportionate system that tracks current property prices will ensure that revenue is raised from residents of expensive houses – in many cases the same people as those who would gain most from cutting or even abolishing stamp duty.

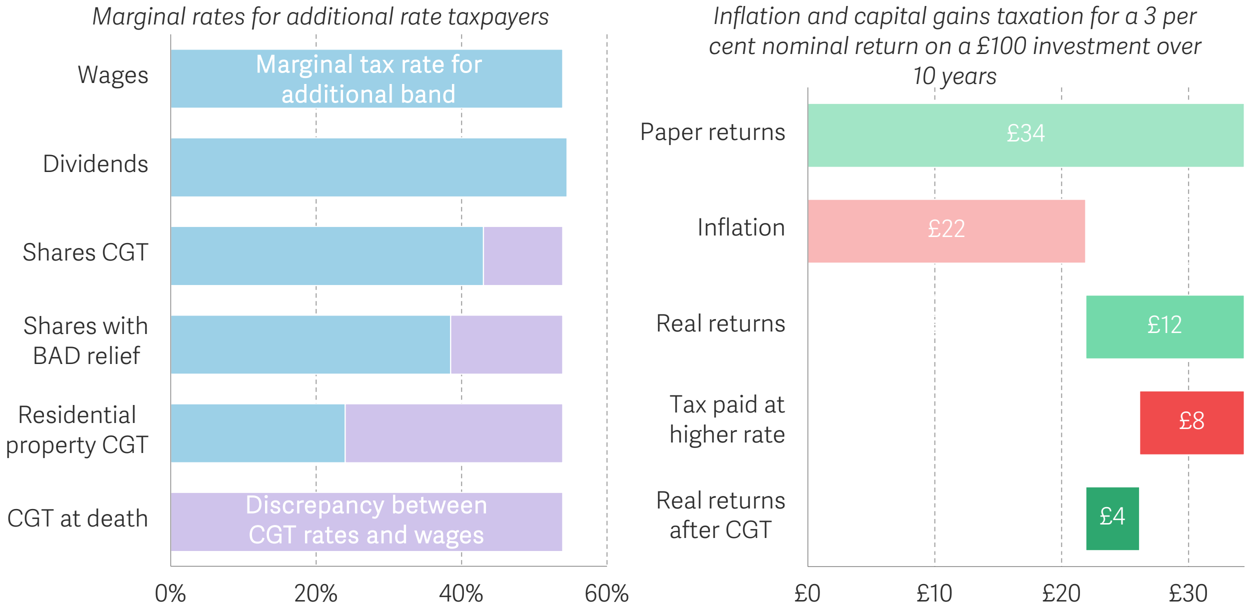
Other taxes specifically relating to property wealth should be considered – such as abolishing the nil-rate band in Inheritance Tax. This is particularly generous given that Private Residence Relief means the gains will never have been subject to Capital Gains Tax. A series of other reforms are also important for securing more equitable treatment for wealth and the income it generates compared with earnings. Closing the obvious escape routes from Capital Gains Tax is crucial. The UK is internationally unusual in not applying a 'settling up charge' on gains relating to the assets of people leaving the country. And, by giving an automatic write-off to gains at death, the system inculcates a perverse incentive for the wealthy to hold onto assets until the very end. Raising £4 billion by closing these loopholes would not only contribute towards rebalancing the tax burden from work towards wealth, but also remove an incentive to hang onto assets that may have a more productive use.

The border between gains and income is hazy. The wealthy can choose between taking profits out of their company as dividends, or liquidating the company and realising those same profits as a capital gain – which is taxed at much a lower rate. The arbitrary tax differences this creates are set out in the left panel of Figure 13. But when taxing capital, we must keep a keen eye on incentives for investment and for this reason the best approach is reforming both the tax base and the tax rate together. The first change should be to the base: introduce inflation indexation so that only real returns are taxed, which would substantially reduce the disincentive to invest and amount to a major pro-growth reform. The impact of inflation is shown in the right panel of Figure 13. Having introduced such an allowance, there would be a strong case for then raising the rate on the real gains. Capital gains on shares should be taxed at the same marginal rate as dividend income. The rate charged on other classes of assets should increase towards the marginal rates charged on income from earnings.[27] A more sensibly structured balance between the base and the rate would be positive for both growth and the public finances.

26 Source: A Dixon et al., The Proportional Property Tax Manifesto, Fairer Share, October 2021.
27 CGT rates on assets other than shares ought to be higher than for shares, given that there is no Corporation Tax to account for with the former.

FIGURE 13: **Random rates: different types of income pay different tax, and earnings often pay more**

Marginal tax rates for additional rate taxpayers (left panel) and the impact of inflation and capital gains taxation for a 3 per cent nominal return on a £100 investment over 10 years (right panel)



NOTES: In the left panel, for employee earnings we include the impact of employer NI. For dividends and CGT from shares (including those benefiting from Business Asset Disposal Relief), we include the impact of Corporation Tax paid at the main UK rate of 25 per cent. The right panel shows the returns from investing £100 for 10 years, with annual rate of return of 3 per cent and inflation at 2 per cent.
SOURCE: RF analysis.

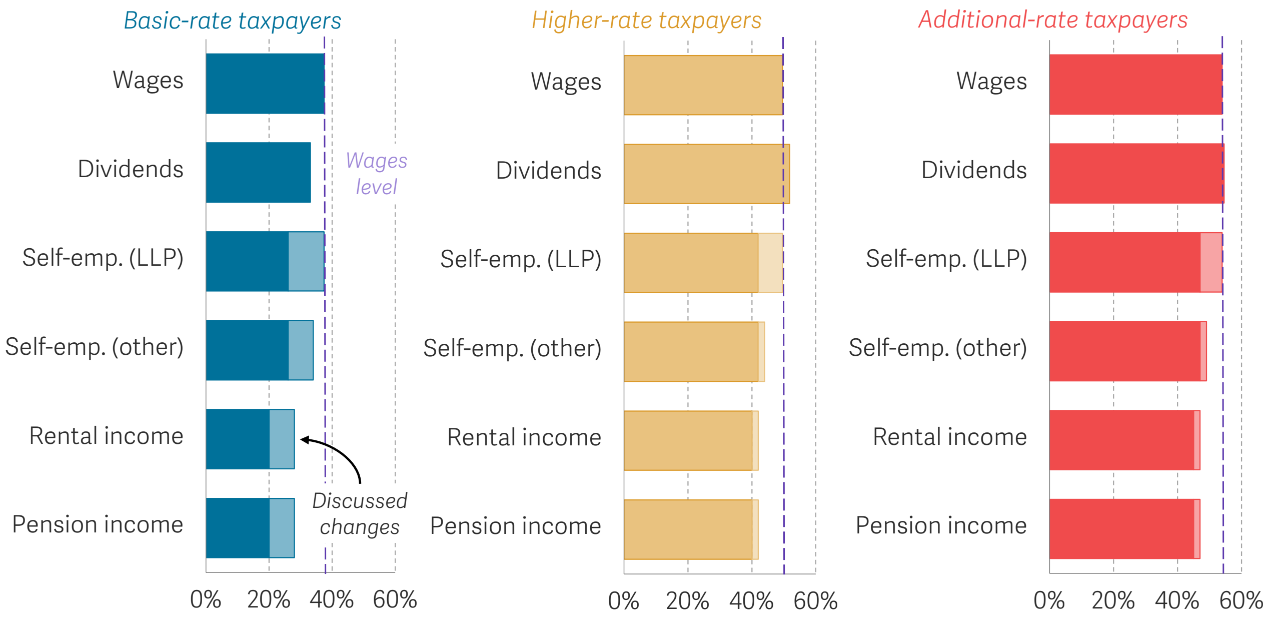
One small, specific but worthwhile change for levelling the playing field between those who earn income through wages and those who earn from holding wealth concerns Limited Liability Partnerships. The income of partners, who tend to be well-paid professionals such as lawyers, accountants and consultants, is not liable for employer National Insurance. On the principle that they should be subject to the same tax treatment as everyone else, this exemption should end.

A far wider imbalance in the tax treatment of work and the income from wealth arises because earnings are liable to National Insurance, while income from investments are not. Cutting the employee rate of National Insurance while increasing Income Tax would rebalance the tax burden in favour of employed workers, while asking more of groups that currently face lower tax rates, such as the self-employed and pensioners. The possible scope of such a change can be seen in Figure 14. Thanks to the wider tax base of Income Tax, a point-for-point swap can, as we have previously highlighted be used to raise revenue.[28]

28 A Corlett, Call of duties: Revenue and reform for Autumn Budget 2025, Resolution Foundation, September 2025, https://doi.org/10.63492/rc611.

FIGURE 14: **Scope for levelling up? Tax rates on employment incomes are often much higher than that for incomes of other types**

Existing and potential marginal tax rates 2026-27, including employer NI and Corporation Tax where appropriate



NOTES: For employee earnings we include the impact of employer NI. For dividends, assumes Corporation Tax has been paid at the main UK rate of 25 per cent. For pension income, the chart shows pension income from employer contributions.
SOURCE: RF analysis.

The tax system also offers privileges to relatively older groups over the young which could reasonably be restricted. It's fair to offer tax relief on income saved in a pension which will later be turned into a taxable retirement income. It may also be that a degree of tax-privileging beyond that is justified as an inducement to save. But in practice, the range of existing tax reliefs goes beyond this. In particular, on reaching retirement savers can take up to 25 per cent – up to a high limit of £268,275 – as a tax-free lump sum. This is money that is saved out of tax-free income, which then accrues tax-free returns and remains untaxed when it is taken out. A reduced limit of £100,000 would be more appropriate. Such a change would only affect around one-in-five new retirees, bringing in £2 billion only from that minority of retirees who are best placed to afford it.[29] As well as bringing in useful revenue, this reform could curb the temptation for a group of higher-paid and particularly productive people to give up on work earlier than they otherwise would.

Social Security: a tighter focus on the most pressing needs

More than half of Britain's large social security bill is devoted to pensioners.[30] Spending will continue to rise in line with their growing numbers in our ageing society. That much is almost inevitable and in some ways desirable, but in light of the fiscal challenges we have

29 M Broome, A Corlett & G Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023.
30 DWP, Guidance and methodology: Benefit expenditure and caseload tables, April 2026.

described it is important to apply a sceptical eye on anything that ramps spending up beyond what the demographics require.

The current pensions uprating formula – the so-called 'Triple Lock' – cannot be allowed to continue indefinitely. It works over time to increase the State Pension relative to earnings. Because inflation and earnings have been volatile since it was introduced in 2012, the non-earnings element of the lock has been triggered in eight years since then, costing an expected £15.5 billion annually by 2029-30.[31] This makes sense if the pension was deemed too low, but – logically – there must come a point beyond which it can no longer be defended. Today the New State Pension stands at 35 per cent of average earnings. Ministers should specify if they think this is an acceptable ratio, and – if their judgement is 'not yet' – they should specify what an acceptable ratio would be. Once that target ratio is met, the arbitrary Triple Lock should itself be retired, with a switch towards a 'smoothed earnings link' which will – over time – permanently maintain the pension's target value relative to earnings.

Working-age social security costs less than pensions overall and, despite widespread claims about expenditure 'spinning out of control', has been broadly stable as a share of national income over the last couple of decades. This is money that directly supports family budgets and living standards, particularly towards the bottom end. As such, it is incumbent on anyone claiming big savings in this area to explain exactly what they mean. Nonetheless, in the face of a simultaneous crunch in both the public finances and family finances, the duty on the Government is to see to it that access to the basics of life is protected, even if that has to come at a cost elsewhere.

One field where this is certainly not currently happening is in respect of rent support. The Local Housing Allowance is no longer pegged to modest typical rents (the 30th percentile within the local area), but – by default – simply frozen in cash terms. The upshot is poorer renters having to dig ever-deeper into their already-low incomes just to keep a roof over their head. On average, the shortfall between 30th percentile rents and what the LHA covers is now £165 per month for a 2-bedroom property in England, and is expected to reach record levels later this year.[32] Some tenants will inevitably end up with a choice between losing their home and sinking into unsustainable debt. This cannot be allowed to continue. Instead, a reliable link between the LHA and modest rents must be restored. This would cost £2.5 billion in 2029-30.[33]

If this had to be financed from within the working-age welfare budget, one way to fund it would be to increase the 'taper' on Universal Credit from 55 to 59 per cent. This is not

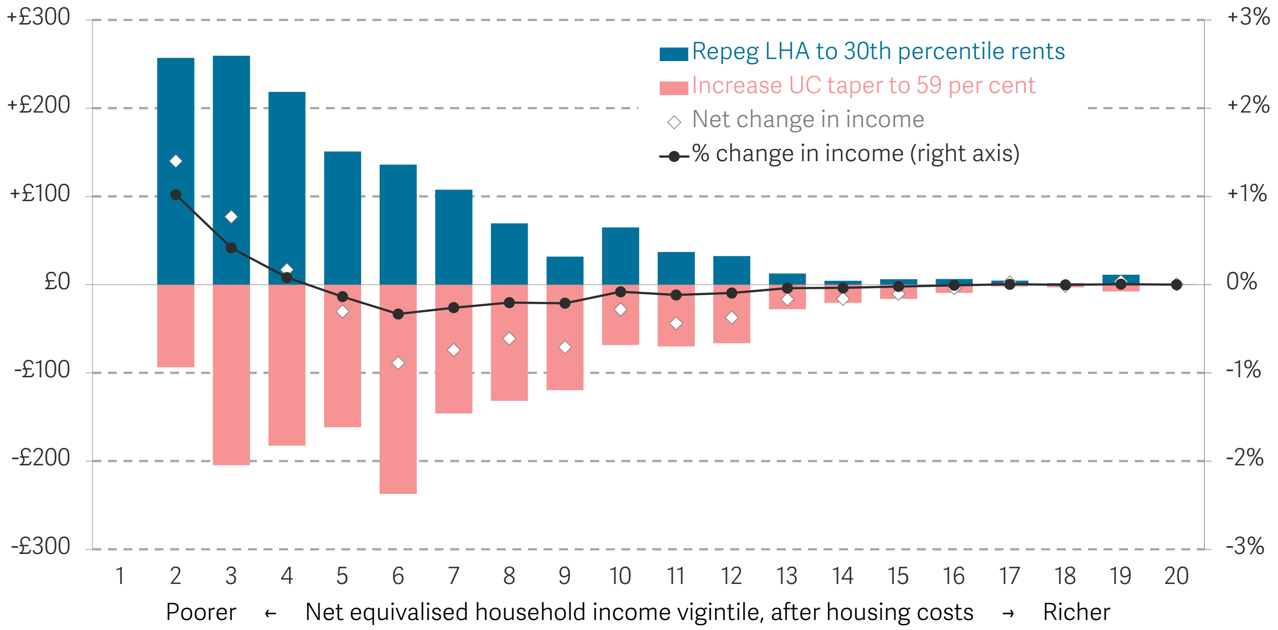
31 Office for Budget Responsibility, Fiscal risks and sustainability, July 2025.
32 RF analysis of VOA, Local Housing Allowance rates; ONS, Price Index of Private Rents. See: H Aldridge, Housing Outlook Q4 2025, Resolution Foundation, October 2025. https://doi.org/10.63492/vbh1305.
33 RF analysis of DWP, Family Resources Survey using the IPPR tax-benefit model; ONS, Price Index of Private Rents.

an option without downsides: it means workers on the National Living Wage receiving Universal Credit will see an extra 51 pence in benefits being withdrawn for every hour they work (outside of any work allowance). Figure 15 shows how the combined reform would redistribute from relatively better-off benefit claimants (who are often just a little below the middle of the income spectrum) towards the very worst off.

Despite the fact that some working families would lose out, the effects on the incentive to work are mixed. A sharper taper would mean people move out of the whole system of benefits quicker than they otherwise would, and so are no longer exposed to any taper at all. And a taper of 59 per cent is still not high by the standards of the recent past: Universal Credit was tapered at 65 per cent before April 2017, and then at 63 per cent before Chancellor Rishi Sunak reduced it in response to a row regarding his overnight withdrawal of an emergency pandemic benefit top-up. Going much further back, the old Family Credit benefit was tapered at 70 per cent.[34] The more recent trend, however, has been to neglect the absolute level of the basic safety net in favour of the interests of the relatively better-off families who receive some Universal Credit. For the prize of restoring proper housing support, a slightly higher taper is a trade that, on balance, would be worth making.

FIGURE 15: **Homes first – repegging Local Housing Allowance to rents while increasing the UC taper rate would help the very poorest at the expense of working claimants**

Estimated change in cash terms (left axis) and as a proportion of household income (right axis) due to combined reform: UK, 2029-30



NOTES: 2026-27 prices, deflated by CPI.
SOURCE: RF analysis of DWP, Family Resources Survey using the IPPR tax-benefit model; ONS, Price Index of Private Rents.

34 M Brewer, K Handscomb & L Try, Taper cut: Analysis of the Autumn Budget changes to Universal Credit, November 2021.

One notable area of working-age social security costs that has been rising is the bill for disability related benefits which, among young people, for example, has come from an increase in the number of applications and correlates with evidence on the worsening health of the population.[35] It is a complex area where the effects of the pandemic, underlying health and the cost of living squeeze are hard to untangle from the structure of the benefits system itself. The scale of the increase needs interrogating and the root causes identified for any reform to be successful. This Government, however, blundered in 2025 by latching on to particular cost-cutting measures before it had done all of this work – and was subsequently forced to back down. It must be hoped that ministers will have learned that this is not an area where they should expect to find short-cuts and instead, they should wait for the Timms Review of Personal Independence Payments to come up with more effective, and better-grounded, proposals. The role of employers cannot be neglected either and pursuing the reforms proposed in the recent Mayfield review should be a priority.[36]

A smarter state: targeting support and services where they can make most difference

As well as cash benefits, smart prioritising is increasingly important within broader public budgets. For the Government and indeed wider society, there is a lot at stake with public services, from sorting out Special Educational Needs provision to reducing the appalling backlogs that dog many criminal courts. It is always worth looking to technology, innovation and organisational reform to see if they can help solve these problems, and there are times when bright new ideas really can enable services to do much more with less.

It is, however, unwise to rely on this in general: the distribution as well as the total level of resources is always important. And with both tax and borrowing already high, and with a potential need to find more funds for defence from somewhere, it is not realistic for departments to expect their budgets will be topped up. Day-to-day spending across has already risen by 2.3 per cent since the Election, and the focus should be on increasing the efficiency of public services, living within these plans.

Among other things this is likely to require a degree of restraint on public sector pay. Public pay is, of course, a huge subject in itself – the role of the review bodies, recruitment and retention issues, and the potential damage done by strikes will all be important. Ministers running services are obviously duty-bound to be concerned about service quality. As we face into another cost of living shock with strained public finances, the focus must be on targeting pay rises according to recruitment and retention

35 A Clegg et al., Lost in transition: An examination of why the UK NEET rate is high and rising, Resolution Foundation, April 2026, https://doi.org/10.63492/cxo2244.
36 DWP & DBT, Keep Britain Working: Final report, November 2025.

challenges. Compensating public sector workers for the higher inflation caused by the war in Iran would mean fiscal policy acting to exacerbate rather than support the objective of keeping interest rates down.

If – and only if – proper discipline is maintained, can existing budgets be redirected towards the support and services that matter most for households whose living standards are not cushioned by property or other private wealth - and in particular for the younger generation, which has been facing difficulties on so many fronts.

The resurgence of young people not in employment, education or training needs urgent attention. The answer is likely to require at least three elements. First, directly addressing the health of young people, especially mental health, which appears to be behind a lot of the rise in economic inactivity. Second, keeping more young people in education and training for longer, including by tracking their participation better and ensuring that the bulk – at least two thirds – of the apprenticeship levy is reserved for under-25s. Third, transcending the effective binary in the benefit system which in practice often either imposes full work conditionality or leaves people to drift. Health issues and other barriers to work need to be taken seriously, but that means coming up with employment and other support that is tailored for individual situations.[37]

Too many young people – particularly those on lower incomes – are also struggling to get on the housing ladder.[38] Since the financial crisis, the number of mortgagors among low-to-middle income households has fallen by three times as much as it has for those towards the top of the income distribution. The barrier here is not that income is too low: it is that they lack the deposit to get a mortgage. Besides upping house building, the Government should do more. A Starter Deposit equity loan scheme could provide first-time buyers with a 5 per cent deposit on a starter home – a more targeted approach than previous Help to Buy schemes.

The Government must reset from a position of honesty about the challenges we face and how it will address them

It is, then, possible to fashion a long-term programme which is on the side of growth, work and the young at the same time, even within the constraints of the public finances. Tax measures which remove distortions can raise revenue and boost growth at the same time. Choices within the welfare system can be made to support the poorest without increasing the bill. And day to day public spending is at a level where we should demand better services for the money being spent. As we stressed at the start of this paper,

37 A Clegg et al., Lost in transition: An examination of why the UK NEET rate is high and rising, Resolution Foundation, April 2026 https://doi.org/10.63492/cxo2244.
38 H Aldridge, S Pittaway & J Smith, Credit where credit's due?: Unpacking the distributional impact of Britain's mortgage lending rules, Resolution Foundation, March 2026, https://doi.org/10.63492/10.63492/udgn419.

however, we are stuck in dark times for living standards. Vague claims that some large and unspecified cut to the working-age welfare budget could make all the sums add up, or that borrowing for defence is not real borrowing, should not be taken seriously. They merely provide cover for an agenda that would make living standards worse. It is precisely because living standards –especially for those at the bottom – must be a top priority that thoughtful but ruthless prioritisation is needed instead.

None of this will be easy, but then the evasions of the last election campaign aren't working for anyone anymore. The only remaining viable strategy is facing, then fixing, the state that we find ourselves in.

The Resolution Foundation is an independent think-tank dedicated to lifting living standards in the UK. We focus particularly on households with low and middle incomes; those on low pay or in precarious work; and those vulnerable to financial shocks. We also investigate fairness between the generations in our Intergenerational Centre.

We aim to provide rigorous analytical work, develop effective policy proposals, and use our expertise to affect direct change. We analyse the trends and outlook for living standards, including for different age groups, family types, and levels of household income and wealth, and seek to promote greater understanding of these. Our research focuses both on the specific areas of the economy that matter most for people's living standards, including work and housing; and on economic growth and productivity as the route to sustainably higher living standards. We also examine the role of government in improving living standards including through taxes, social security and public services.

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