The Resolution Foundation view on the Budget

Synopsis: The Resolution Foundation has followed the Institute for Fiscal Studies in looking forwards to this month's Budget.

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The Resolution Foundation (RF) has published a suitably Dickensian paper, 'Great Expectations in Hard Times' examining the background to the Autumn Budget. Its assessment of the situation is not that different from the Institute for Fiscal Studies (IFS), although the tone is somewhat less neutral than that of the IFS…

The public finances are looking more strained than at the Spring Budget

This will be no surprise, given the news flow emanating from Rachel Reeves, etc., since the election, but the RF's reasoning is interesting…

- The Chancellor's (in)famous £22bn black hole is 'consistent with the emerging outturns which show that significant in-year departmental overspend in the 2024/25 fiscal year is taking place'. The RF notes that the £8bn overshoot in borrowing in the April-August period is consistent with a £20bn overspend. The RF reckons that by 2029/30, £19bn of that additional spending pressure will still be present.

- On the other hand, economic growth in 2024 looks likely to be around 1%, usefully higher than the 0.6% Office for Budget Responsibility (OBR) March projection. Similarly, price inflation and earnings growth are both higher than the OBR assumed. Together, all three are good news for the Exchequer as bigger *nominal* numbers means more revenue. However, this is offset somewhat by higher benefit costs due to the price and earnings inflation.

- The net result on the RF's calculation is that the 'headroom' in 2029/30, based on the *current* fiscal rules, falls to £0.5bn (roughly equivalent nothing) against the £8.9bn for 2028/29 in the March OBR Economic and Fiscal Outlook.

Taxes will have to rise to avoid a return to austerity

The RF, like many others, is uncertain of the exact meaning of the pledge given by Reeves and Starmer of 'no return to austerity'. It has therefore used the interpretation adopted by the IFS, i.e. that 'unprotected' spending (commitments other than those made for the NHS, schools, childcare, defence, and aid) would need to rise in line with national income. The implication is an extra £21bn of spending by 2029/30. However, the RF calculates that even this would still leave the level of real, per-capita, spending for unprotected departments at 2016/17 levels.

Covering this figure would require 'at least £20bn' in new tax rises on top of the £24bn a year of increases already scheduled to happen between 2025 and 2027, e.g..

- The continuation of income tax and National Insurance (NICs) threshold freezes;
- The end to pandemic business rates relief for hospitality;
- A return to regular increases in Fuel Duty alongside the removal of the 'temporary' 5p/litre cut; and
- The planned reductions in the Stamp Duty threshold.

The RF favourites for new revenue, given Reeves' self-imposed constraints on taxes covering 75% of Exchequer income, are capital gains tax (CGT), inheritance tax (IHT) and employer's NICs on pension contributions.

Investing to grow means rewriting the fiscal rules

On the last Government's plans, public-sector investment is set to fall from 2.4% of GDP to 1.7% by 2028/29. The RF calculates that to reverse these (unspecified) investment cuts imply an additional £30bn in annual capital spending in 2029/30. In theory, this would all be borrowed as the current budget is meant to be in balance by 2029/30 under Reeves' first fiscal rule. In practice, the second, debt-falling-in-year-five fiscal rule is an obstacle to piling up the borrowing.

The RF solution is to redefine debt, a course which the rumour mill suggests that the Chancellor is ready to make. After going through the various options, the RF leans towards the broadest definition, Public Sector Net Worth (PSNW – 'The Snew'). This would give the Chancellor more than £50bn extra headroom after five years. As the rule would combine debt and assets, the five-year requirement would move to an *increase* (in net worth) between years four and five rather than a decrease (in net debt). To add to the mirror image complexity, PSNW was £727.6bn in *deficit* in August 2024, so we would again be talking about a reduction in deficit. Over the last 12 months the PSNW deficit has widened by £120bn.

Fiscal policy is set to loosen at the Autumn Budget, but will still be tightening in the years ahead

This looks a surprising statement until you consider the last Government's plans and where we are today. Those previous plans were so stringent (remember the OBR chief's 'worse than fiction' comment) that allowing for at least some of the 'black hole', the Chancellor is likely to be making a net giveaway (via extra borrowing), even if she raises the £20bn referred to above. However, the RF says that the loosening is very much a relative measure. Its calculations suggest that 'the fiscal stance will still be at its tightest since Gordon Brown was Chancellor.'

Comment

As RF concludes, the Chancellor is likely to face trade-offs between improving living standards, bolstering flagging public services and bringing down Government debt.

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