INSTITUTE FOR GOVERNMENT

Tax and spending

Questions facing the government in autumn 2021

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Summary

Rishi Sunak faces a crucial autumn that will set the course of public spending and taxation for the rest of the parliament. He will announce departments' budgets for the next three years at the first multi-year spending review since 2015. He also faces big decisions over the future of social care, which the prime minister has pledged to "fix", and Universal Credit. This Insight paper looks at how the public finance forecasts are likely to change and how much room for manoeuvre this will give the chancellor.

The good news for Sunak is that the economy has recovered more quickly than the Office for Budget Responsibility (OBR, the government's official independent forecaster) expected back in March. Most other forecasters, including the Bank of England, are now more optimistic about the economy in the medium term too. If the OBR upgrades its outlook for the economy in line with the Bank, the forecast for borrowing in 2025/26 – the end of the OBR's current forecast horizon – could be reduced by around £25 billion.

The chancellor has not yet put in place any new fiscal rules to replace those he ditched to allow flexibility in the government's pandemic response, but he has stated that the government should not borrow for day-to-day spending in normal times. If he adopts that as a formal rule, he might – like his predecessors – want to build in around 0.5% of GDP headroom against it. Even allowing for that, the better outlook for the economy would allow him to spend an additional £12bn over and above his March 2021 plans.

Ordinarily, an extra £12bn would give a chancellor an easy autumn. However, the March forecast was based on several tight spending assumptions that mean £12bn will not be enough to avoid difficult decisions. Pressures include:

- **The state pension triple lock:** Average earnings growth – one of the three measures against which the triple lock is set – has been higher this year than anticipated, but the increase is artificially high because so many workers were furloughed last year. If the chancellor sticks to the letter of the triple lock, he would have to spend £4bn per year more.
- **Universal Credit:** The 'temporary' £20-per-week uplift is set to stop at the end of September, but this may prove difficult politically. Cancelling the cut would cost £6bn a year.
- **Social care:** The prime minister has pledged to "fix" social care – an objective successive governments have failed to address – and reports suggest he intends to introduce a cap on care costs. To do so and meet social care pressures could cost £10bn per year.
- **Spending review:** Provisional plans laid out in March include barely enough money to meet demographic-related demand pressures. They allow for no extra spending to deal with coronavirus-related costs beyond this year (such as continued test and trace, and vaccination programmes) or backlogs created by the pandemic. More money will be required if the government wants to meet these spending needs.

If the chancellor wants to address these pressures, while remaining committed not to borrow for day-to-day spending, he would need to raise taxes or find cuts to spending elsewhere. If he does decide to increase taxes – for example, to pay for social care – he should:

- Raise taxes in a way that does not make the UK's already imperfect tax system worse. Increasing National Insurance contributions (NICs) to pay for social care would worsen the bias in the tax system away from employees and towards the self-employed. It would also – inappropriately – fall only on those under 65, who use the social care system least. An additional income tax levy on over-40s would not suffer from these problems but would complicate the tax system further.

- Package tax increases with the additional spending they help pay for. In the past, chancellors have failed to deliver tax reforms because spending increases were announced first, making a standalone tax increase appear less justified to the public when later announced, making it more difficult to deliver. Any announcement should happen simultaneously to stop Sunak making his predecessors' mistake.

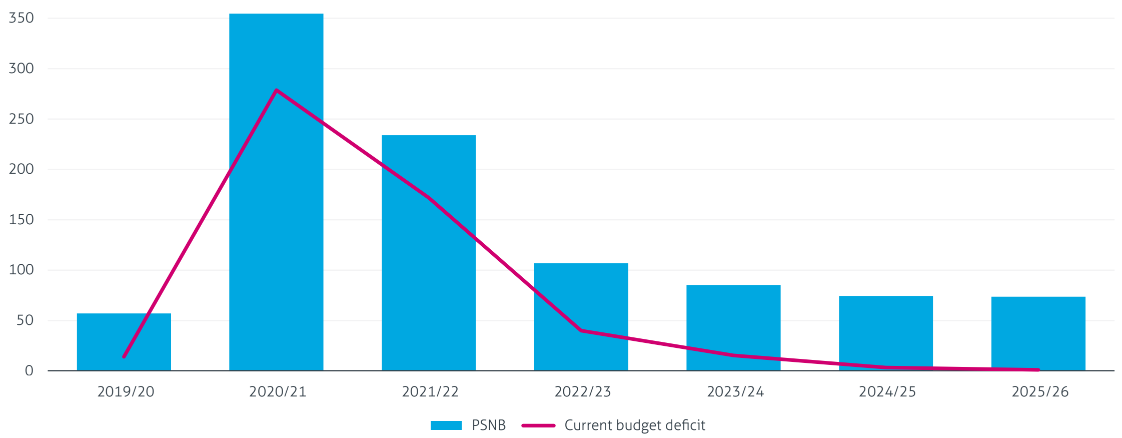
Introduction

In the March 2021 budget, Rishi Sunak allocated a lot of extra money to allow the government to continue tackling the short-term impact of the pandemic. But he laid out tight fiscal plans for the years up to 2025/26 to help reduce borrowing – including a large corporate tax rise and a freeze to income tax thresholds to bring in more money, and tight limits on day-to-day public spending from next year onwards.

So far, Sunak has not set out any firm fiscal rules. But he did, in March, state that "in normal times, the state should not be borrowing to pay for everyday public spending" and that "we cannot allow our debt to keep rising".[1] More recently, the 'compromise' that Sunak struck with Conservative rebels over controversial cuts to overseas aid spending – that he will return aid spending to 0.7% of gross national income (GNI) when the government is no longer borrowing for day-to-day spending and when debt is falling[2] – further underlines the government's commitment to getting to that fiscal position.

The fiscal forecasts in March were (just) consistent with the chancellor's ambition not to borrow for day-to-day spending in 2025/26, as Figure 1 shows. But there was no leeway in those forecasts for tax giveaways or extra spending. This paper looks at how the outlook has changed since then. The economy has rebounded more strongly than was expected and many forecasters now think the long-term economic damage from Covid will be less severe. This makes the fiscal sums easier. However, we also highlight the many areas in which the March budget was predicated on future actions that will be very difficult for the government to deliver. This means Sunak still faces some very tough choices in the autumn as he prepares to present his multi-year spending review and potentially also a new budget.

Figure 1 **Net borrowing and current budget deficit, March 2021 OBR forecast, £ billion**



Source: OBR Economic and Fiscal Outlook: March 2021. PSNB = public sector net borrowing.

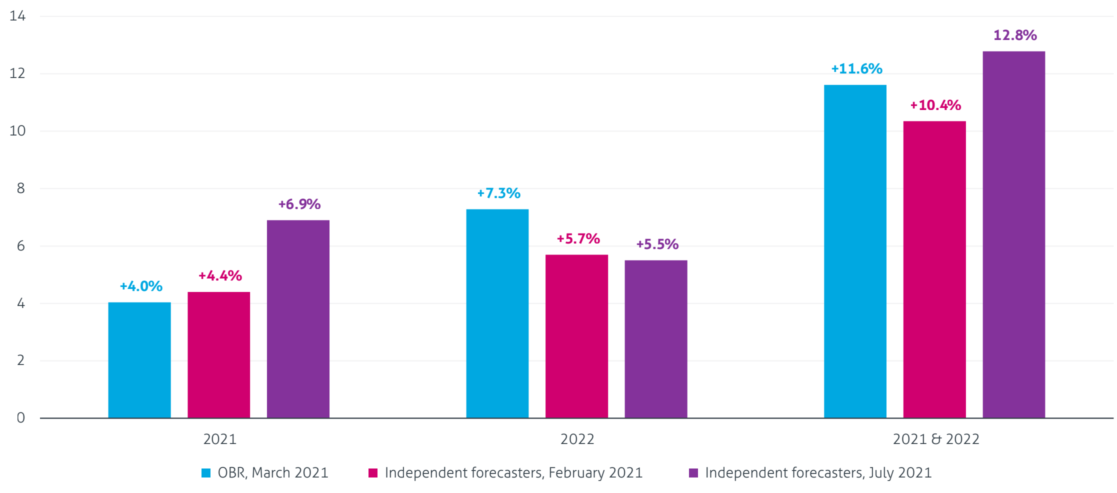
How has the economic and fiscal outlook changed since the spring?

The economy is bouncing back strongly

The last time the Office for Budget Responsibility (OBR) published any official economic and fiscal forecasts was in early March 2021. At that time, the coronavirus vaccine roll-out was in its early stages but since then it has gathered pace and consumer confidence and spending have rebounded as the economy has reopened. The economy has recovered more quickly than most forecasters (including the OBR) expected in the near term. The OBR forecast in March predicted that GDP would be 7.8% below its 2019 Q4 level in the second quarter of this year. However, the initial estimate is that it was only 4.4% down.[3]

Most forecasters predict that this stronger performance in the short term will translate into a stronger medium-term outlook as well. Taking the average of the most recent projections by independent forecasters shows that they now expect that the UK economy will grow more over this year and next than the OBR thought in March. As Figure 2 shows, while independent forecasters were on average more pessimistic than the OBR at the start of the year, the average of independent forecasts is now for the UK economy to be 12.8% larger in 2022 than in 2020, compared to the OBR's latest forecast of 11.6%. The Bank of England (BoE) also now expects the economy to grow more quickly and get closer to its pre-pandemic growth path in the medium term than it did at the start of the year (Figure 3).

Figure 2 **OBR and independent forecasts for real economic growth in 2021 and 2022**



Source: OBR Economic and Fiscal Outlook: March 2021 and Treasury survey of independent forecasters.

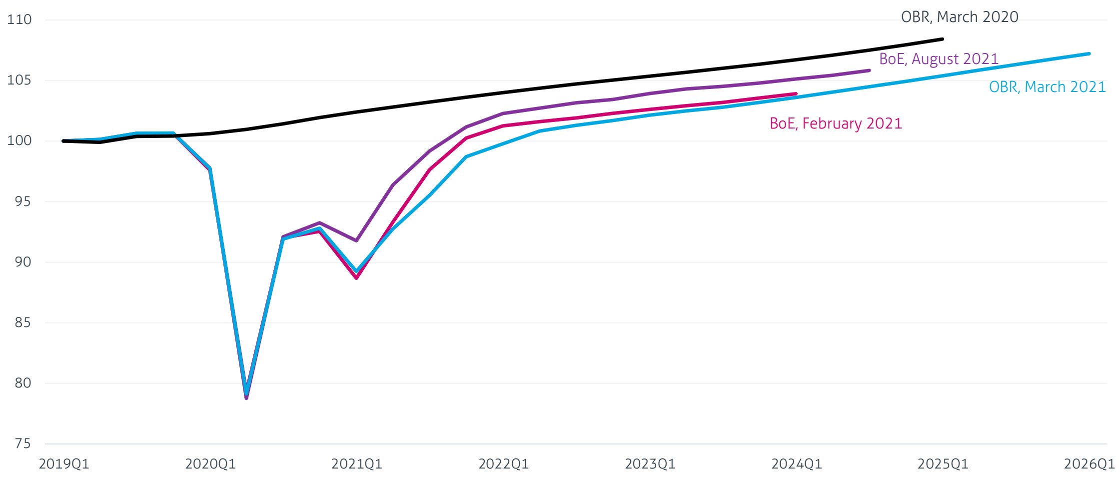
Earlier in the year, forecasters were relatively more concerned that workers would have lost skills and become detached from the labour market during lockdowns and that businesses would have cancelled investment, harming productivity. But these concerns have been calmed by a quicker than expected recovery – and, in particular, a stronger labour market with lower-than-expected unemployment.

Forecasters are now more optimistic about the medium term because they think Covid will leave fewer permanent 'scars' on the UK economy than they previously expected. It is this medium-term outlook that will affect the public finance position in the mid-2020s, when the chancellor has indicated he wants to stop borrowing for day-to-day spending.

That said, the extent of pandemic 'scarring' remains highly uncertain, and some forecasters – such as Citi [4] – still expect scarring to mean the economy will be 3% smaller than it otherwise would have been. This is in line with the OBR's March forecast. However, the BoE and others' more optimistic outlook means the OBR is likely to follow suit when it produces its next forecast, to be published on 27 October.[5]

If the OBR were to revise its forecast for the economy in the medium term in line with the BoE's August 2021 forecast, higher GDP would translate into much higher tax revenues and therefore reduce the forecast for borrowing. We would expect this to reduce borrowing in 2025/26 by £32bn (1.2% of GDP).[*]

Figure 3 **Real GDP forecasts from OBR and Bank of England (2019 Q1 = 100)**



Source: OBR Economic and Fiscal Outlooks, March 2020 and March 2021; Bank of England monetary policy reports, February 2021 and August 2021.

But higher interest rates on government debt will increase public spending…

A stronger economy would be good news overall for the public finances. Additional economic activity means more income, consumer spending and profit, which in turn means higher tax revenues. However, it would also increase some aspects of public spending, which would partially offset the gain in tax revenues.

The better outlook, as well as higher inflation (covered below), means that interest rates are now expected to be higher than in the OBR's March forecast. This is because the BoE is more likely to increase the base rate if inflation is higher and the economy is stronger, while higher economic growth also makes other assets more attractive to investors and so the government needs to offer a higher return on its debt.

[*] We calculate the effect of higher GDP on the public finances by taking the difference in borrowing and GDP between the 'central' and 'upside' OBR scenarios in the November 2020 Economic and Fiscal Outlook and assuming that the same relationship between the two will apply to the next forecast revision.

Two interest rates matter for the public finances. In normal times, the only interest rate that would matter would be that charged on government bonds. Any new government borrowing will need to be financed at this rate, so any increase means debt interest costs will rise. However, the BoE's quantitative easing (QE) programme has purchased £875bn of government bonds since 2010: these are financed at the base rate – set each month by the BoE's Monetary Policy Committee (MPC) – so any increase in the base rate now feeds through directly into higher debt interest spending.

Market expectations for the base rate have increased since the OBR's last forecast because projections for growth and the price level (the MPC's mandate is to keep inflation around 2%) have increased. In the next couple of years, the base rate is expected to be around 0.3 percentage points higher than in March 2021. However, the gap is smaller by the end of the forecast and in 2025/26 it is expected to be only 0.1 percentage point higher (0.6% rather than 0.5%). This small difference will increase the cost of financing the bonds purchased through QE by £0.9bn in 2025/26.

Shortly after the OBR closed its March 2021 forecast investors also increased their expectation of future government bond interest rates by around 0.3 percentage points. But in recent months expectations have changed again and bond yields are now only 0.1 percentage points higher than anticipated by the OBR. If the next OBR forecast revises bond interest rates up by 0.1 percentage point across the forecast period, it would add a further £0.7bn to debt service costs in 2025/26.

The overall effect of higher interest rates (on government bonds and the BoE base rate) is therefore to increase spending by £1.6bn in the medium term, which partially outweighs the benefits to the public finances of stronger growth that come from higher tax revenues.

...as will higher inflation

One of the biggest economic surprises in recent months has been higher inflation. In March, the OBR expected consumer price index (CPI) inflation to remain at or below the MPC's 2% target throughout the period to 2025/26. However, in June 2021 the annual inflation rate was already 2.5%, and the BoE now expects it to peak at 4% in the first quarter of 2022 and remain above 2% until the end of 2023, although the path for inflation is uncertain and the BoE forecasts a 30% chance that inflation will be below 2% in 2022 Q1.[6] This anticipated spike in inflation is driven by the stronger-than-anticipated global recovery: the prices of some commodities have increased globally as demand has recovered, while other products used as inputs to a variety of manufacturing processes are suffering from supply chain bottlenecks.[7] For example, a global semiconductor shortage is increasing the price of cars and other products.[8]

Higher inflation has several effects on the public finances.

On the spending side, most working age benefits and public sector pensions are uprated in line with CPI inflation each year. Furthermore, around 20% of UK government bonds are index-linked, which means that the amount the government is required to pay investors increases when growth in the retail price index (RPI, an alternative inflation measure) increases. Both these factors mean government spending rises when inflation increases. However, the latter (debt interest) only has an impact on the public finances in the year when inflation is higher, rather than meaning spending will be higher in every subsequent year.*

On the tax revenues side, the business rates multiplier (which determines business rates bills) also increases in line with CPI, while most rates on duties (including on alcohol, cigarettes and, in theory, fuel) automatically increase in line with RPI. Effectively, this means that the tax rate increases when inflation increases and so these act to increase government revenue.

Thresholds in the National Insurance contributions (NICs) and income tax systems would ordinarily increase in line with CPI as well. This acts to reduce the tax take because an increase in thresholds means that less income is taxed at each rate. However, the government has announced that the income tax thresholds will be frozen until April 2023. In effect, this means that the nominal freeze to allowances will now be a bigger tax increase – and more painful for taxpayers – than originally intended.

Table 1 shows how each of these would affect the forecast – relative to the projection set out in March – if the OBR outlook for inflation were to mirror the BoE's latest assessment. The impact would be largest in 2022/23, increasing borrowing by £9.7bn, as the largest single impact comes through higher debt interest spending. In 2025/26, borrowing would be £5.6bn higher due to higher inflation if incomes and spending did not also increase more quickly to keep up with inflation.**

Table 1 **Effect of higher inflation on the public finances, compared to March 2021 forecast**

	Change in projected deficit in 2022/23	Change in projected deficit in 2025/26
Spending	**£9.8bn**	**£5.9bn**
Welfare and public pension spending	£2.2bn	£5.9bn
Debt interest spending	£7.6bn	£0
Tax receipts	**–£0.0bn**	**–£0.2bn**
Business rates	–£0.3bn	–£0.7bn
Duties	–£0.4bn	–£1.1bn
National insurance thresholds	£0.7bn	£1.6bn
Total net effect	**£9.7bn**	**£5.6bn**

Source: IfG calculations using OBR ready reckoners and Bank of England inflation forecasts. We assume that the OBR forecast for inflation is line with the Bank of England August 2021 forecast for CPI and that the forecast for RPI increases by the same amount. Figures may not sum due to rounding.

* In other words, it is linked to the inflation rate, rather than the price level.

** Specifically, the OBR estimates of the impact of inflation assume that nominal incomes and consumption are unchanged.

The fiscal outlook is better than in March

Overall, the rosier economic outlook is good news for the chancellor and makes the public finances healthier. Even after accounting for higher inflation and interest rates, if the OBR upgraded its economic forecast in line with the BoE's latest projection, borrowing in 2025/26 would fall by £25bn relative to the March forecast.

If the chancellor were formally to adopt a target of no borrowing for day-to-day spending in 2025/26, we would expect him to factor in some sort of 'buffer' against this target. Previous chancellors have, for example, included a buffer of around 0.5% of national income against similar targets. Were Sunak to do this, it would leave him with around £12bn extra to spend in 2025/26 while still sticking to that new fiscal target.

The chancellor is under pressure to spend more

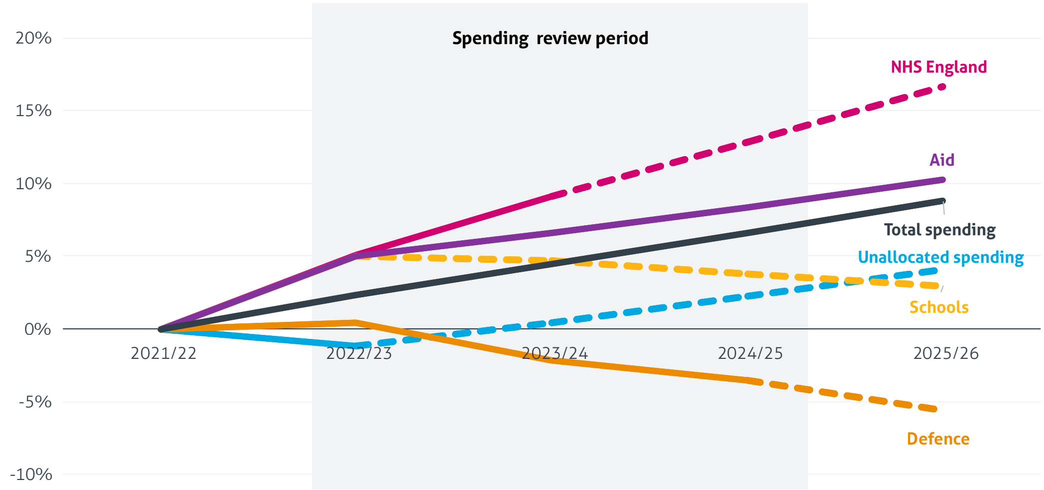
In the March budget, Rishi Sunak outlined broad plans for public spending for the next five years but did not allocate money specifically to individual departments beyond this financial year. Keeping spending as low as he envisaged will be difficult.

More money will be needed to address the legacy of coronavirus for public services

In the autumn spending review the government will lay out detailed plans for spending on public services for the final three years of this parliament (2022/23, 2023/24 and 2024/25). This follows the chancellor's provisional spending 'envelope' included in the March budget – the total amount of money that would be allocated. That figure formed the basis for the borrowing forecasts in Figure 1.

Figure 4 shows projected day-to-day spending for different public services based on the budget spending plans and deals that have already been agreed for the NHS, schools, overseas aid and defence. In total, day-to-day departmental spending is set to increase by 6% in real terms over the spending review period, but the chancellor actually cut £3bn per year (1%) from future spending plans in the budget relative to the plans laid out in November 2020.[9] Once the above settlements are accounted for, the remaining unallocated spending will increase by just 3% in real terms over the spending review period (or 1% per year). This is a faster increase than these areas received in the last two multi-year spending reviews, in 2010 and 2015, and it might just be sufficient to meet new demographic-driven demand pressures on public services that will emerge over the next few years. But it is unlikely to be sufficient also to meet new coronavirus-related pressures.

Figure 4 **Implied spending on day-to-day spending on different services**



Source: OBR EFO and Institute for Government assumptions and calculations.

There are several reasons to think that more money will be needed if the government wants to maintain the quality of public services. So far, Sunak has not allocated any money to deal with coronavirus costs – or related shortfalls of income for local authorities [10] and transport providers – beyond 2021/22. It is likely that more will be needed:

- Extra money will be needed to meet the costs of ongoing test and trace, and vaccination services beyond this year. The OBR estimates that these could cost an additional £3bn in 2022/23 and an additional £1.5bn in 2024/25.[11]
- Worsening physical and mental health as a result of the pandemic could also add further pressures to health services.
- If the government decides it wants a health system that is more resilient to future shocks – possibly by operating with more spare capacity – this would also require even more health spending.
- If more people work from home, maintaining existing transport services will require a greater subsidy from the public purse. The OBR estimates this could cost £1.2bn in 2024/25.[12] These changes to commuting patterns, as well as changes to shopping behaviour, could also continue to have an impact on local authority revenues from car parking, commercial property and business rates.
- Some of the higher costs of providing social care services recorded during the pandemic, such as more widespread use of PPE, could persist.[13]
- Local authorities received fewer referrals to children's social care during the pandemic than has been normal over recent years.[14] The number of referrals has now returned to the higher pre-pandemic levels – but some of those children who were at risk but were not referred might now need more intensive support than if they had been reached sooner.

In the health service and elsewhere, the pandemic has also led to backlogs.

- Between April 2020 and March 2021 there were 100.9 million outpatient appointments, 24.1 million (19.3%) fewer than in the same period a year before[15], which has already contributed to a growing waiting list and waiting times. The Health Foundation estimates that eliminating the Covid-related backlog would require an additional £1.9bn per year for three years.[16]
- Schoolchildren also require additional support if they are to catch up on the almost half a school year of face-to-face education they lost between March 2020 and April 2021 during the pandemic. The OBR estimates that an additional £1bn per year for three years would be needed on top of what has already been announced.[17]
- In the crown court, the backlog of cases is now almost twice as high as it was before the crisis. Additional spending will be needed over the next few years to run the service at a higher capacity to eliminate the backlogs; this would cost around £100m per year for three years.

The chancellor could increase the total amount of money available for the spending review. His recent insistence that any NHS pay award needs to come from within its existing budget indicates that he is not inclined to do so.[18] But returning the quality of public services to its pre-pandemic level will likely require more spending than he has previously announced.

The prime minister has promised to fix social care

Boris Johnson entered government on a pledge to "fix the crisis in social care once and for all".[19] Publicly funded adult social care services have been under strain for many years as local authorities' budgets have been cut back in previous spending reviews. Some private providers left the market after local authorities reduced the amount they paid for domiciliary and residential care services for those who qualify for state-funded assistance between 2010 and 2015 (though local authorities have since started to increase payments again). Local authorities have also pared back what they offer to adults who qualify for care. The number of people who received publicly funded care fell by 27% between 2010 and 2014.[20] The Health Foundation has estimated that the government needs to spend an additional £6bn–£8bn a year by 2023/24 to stabilise the system.[21]

At the end of July, it was reported that the government was on the verge of announcing a new social care settlement, which would extend the generosity of government support for social care costs by capping the amount that individuals would have to pay out of their own pocket for social care.[22] Newspapers suggested the government is considering capping those costs at £50,000. Doing this would cost around £3bn per year on top of the existing system.[23]

Taken together these suggest it could cost closer to £10bn per year if the prime minister wants to meet his pledge to fix social care.[24]

In the event, no government announcement was made – apparently being delayed to the autumn.[25] However, there were reports that the government was proposing to pay for the additional spending by increasing all rates of NICs,[26] while others suggested a new levy on income tax for the over-40s. The Blair government managed to increase NICs in 2002 when it increased NHS spending, and successfully exploited the perception that NICs are used to pay for health care to build public support for this. However, this is only a perception – in practice, NICs operate like any other tax.

Raising taxes to meet the cost of social care could prove difficult, as the most sensible and obvious tax increases to use would violate the 2019 Conservative manifesto commitment not to raise the rates of income tax, NICs or VAT. But if the government is not able to increase taxes it would instead require cuts to other areas of spending worth around £10bn per year if the chancellor is to meet his own objective of eliminating borrowing for day-to-day spending as well as the prime minister's on social care.

The government may not be able to implement the planned cuts to Universal Credit

In March 2020, the government increased Universal Credit (UC) – and Working Tax Credit for those who had not yet transferred to UC – by £20 per week for all recipients, initially until March 2021. This cost around £6bn for the year. The UC increase was then extended to the end of September 2021 as the pandemic and associated restrictions continued into the spring of 2021. But Sunak intends to end the 'temporary' uplift at that point.

Increasing all recipients' incomes by £20 per week is not the best-targeted way to spend £6bn on the social security system, as a recent report by the Institute for Government and Social Security Advisory Committee set out.[27] However, it is still additional income that is flowing to the lowest-income households and ending the uplift would mean millions of households seeing their income drop overnight. Historically, governments have found it difficult to reduce benefit recipients' nominal incomes. For example, George Osborne as chancellor U-turned on planned cuts to tax credits in July 2015.[28] Although cuts to social security have been large since 2010, they have mainly been achieved by freezing entitlements in nominal terms and allowing their real value to erode over time.

The end of September may be a particularly difficult time to reduce UC entitlements because the end of the furlough scheme – scheduled for the same date – will almost certainly see some people shift from furlough to unemployment. For most, this will already be a big drop in income and reducing the generosity of UC at the same time might be especially unpopular. The government is already facing calls to make the uplift permanent, including from the Resolution Foundation[29] and Joseph Rowntree Foundation[30] among others.

If the government were to make the UC £20 uplift permanent, this would increase social security spending by around £6bn in each year of the forecast.[31] The longer-term cost would be much smaller if the government froze UC rates in nominal terms until the real-terms value of entitlements equalled the pre-coronavirus level. For a couple with two children, this would happen if rates were frozen for four years.

More money will also be needed to stick to the letter of the pensions triple lock

Another government manifesto commitment is to preserve the state pension triple lock, which states that the value of the state pension will increase by the largest of CPI inflation, average earnings growth and 2.5% each year. In March 2021, the OBR expected that average earnings growth would be 4.6% in 2021 Q3 (the relevant value to uprate pensions in April 2022). However, average earnings growth in the three months to June 2021 (the latest available data) was 8.8%. If state pensions were to increase by this amount instead, they would cost around £4bn more in 2025/26 than was forecast in March.

However, this figure for earnings growth is distorted by 'base effects': in 2020, average pay was unusually low because many workers were furloughed and receiving only 80% of their salary. It is also distorted by 'compositional effects': the people who have lost their jobs since 2020 have disproportionately been in low-paid jobs, which raises average pay among those still employed. The Office for National Statistics (ONS) has estimated that 'true' earnings growth, stripping out these effects, is between 3.5% and 5%.[32]

If the government were to stick to the letter of the triple lock, pensions would increase by something like 8.8% next April. That would leave pensions in 2022/23 worth 11.5% more in cash terms than in 2020/21. If the state pension had instead increased in line with underlying average earnings over that period, it would have risen only 7%.[33]

Departing from the perverse triple-lock outcome would, technically, constitute a manifesto breach. However, choosing to do so and instead increasing pensions in line with 'underlying' pay increases would maintain the spirit of the commitment, give a more reasonable outcome and save the Treasury £4bn a year.[*]

But there is money available for investment

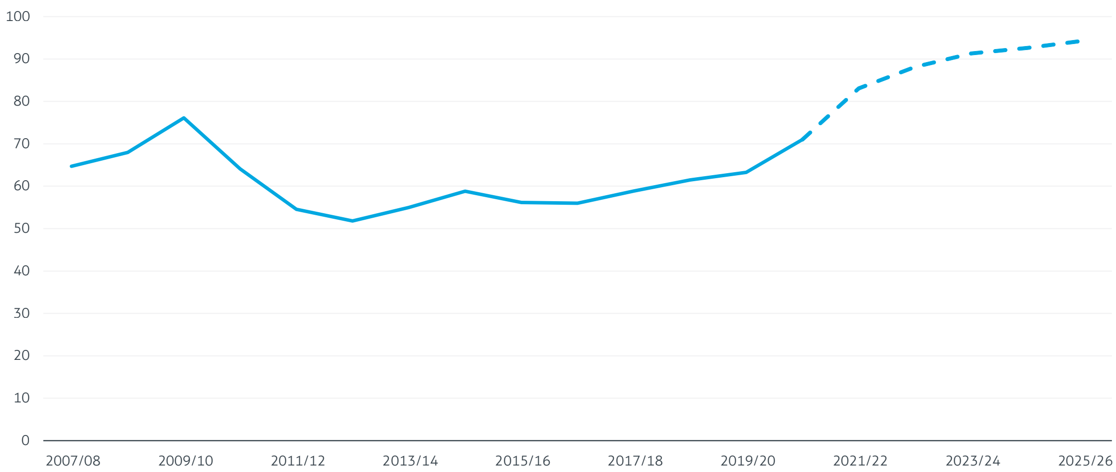
One area of government spending that will not be much constrained is capital, or investment, spending. A fiscal target of current budget balance constrains day-to-day spending but does not limit how much the government spends on investment projects. Sunak's initial set of fiscal rules, set out before the pandemic but then suspended, allowed investment spending of up to 3% of GDP each year. This will encompass spending on high-speed rail, roads, housebuilding, hospitals and prisons – although most of the investment budget remains unallocated.[34]

There is merit to a rule like this because investment spending will mostly benefit future generations – unlike current spending, which mostly benefits current taxpayers – so it is reasonable to borrow to invest, especially when interest rates are low. The plans pencilled in at the March budget would see investment spending by departments (known as capital departmental expenditure limits, CDEL) increase by 11% (or £9bn)

* Estimates from the ONS imply that 'underlying' pay increases this year broadly match the OBR March forecast of a 4.6% annual increase.

in real terms between 2021/22 and 2024/25. This would be a rapid increase, as Figure 5 shows, meaning there will be opportunities to allocate substantial amounts of money to these kinds of projects in the spending review.

Figure 5 **Capital Departmental Expenditure Limits, £bn (2020/21 prices)**



Source: Office for Budget Responsibility, Economic and Fiscal Outlook, March 2021.

However, this would not be the first time that the government has tried to increase capital spending quickly and previous Institute for Government research has highlighted some of the problems that have been faced in the past in doing this. In the mid-2010s a desire to spend more on capital projects was undermined by insufficient project managers and other relevant staff in the departments involved. Given reports that Whitehall staff numbers might be cut back at the spending review,[35] there is a risk that the government could fall into the same trap and so struggle to increase capital spending by as much as planned. The path of spending in Figure 5 already factors in an expectation from the OBR that the government will underspend its planned budget in 2024/25 by 8%.[36]

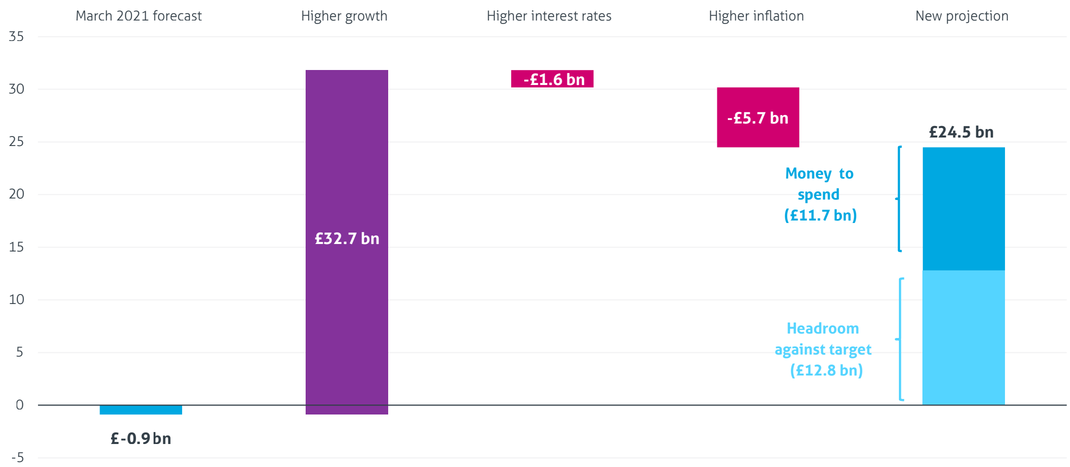
Conclusions and recommendations

The improved economic outlook will probably give Rishi Sunak more room to manoeuvre this autumn than he had in spring. Even after accounting for the effects of higher inflation and interest rates on public spending, if the OBR were to revise its economic forecasts in line with the Bank of England's, the deficit in the medium term (2025/26) would be £25bn lower than forecast in March, as Figure 6 shows.

If the chancellor wanted to commit to a new fiscal rule that required a current budget surplus in 2025/26, he might want to pencil in 0.5% of GDP (or £13bn) worth of headroom against the target to give some leeway, as previous chancellors have done in similar circumstances. That would still allow him to cut taxes or increase spending by £12bn a year relative to his March plans. His freedom would be more restricted if the OBR were not as optimistic as the Bank about the degree of economic 'scarring' from the pandemic, but a forecast improvement is likely.

Ordinarily, a £12bn forecast windfall would give the chancellor an 'easy' fiscal statement in the autumn, with extra money to address different problems. However, the March 2021 budget was predicated on several difficult spending decisions that mean £12bn will not be enough to spare the chancellor difficult choices.

Figure 6 **Projected change in current budget balance before any policy changes**



Source: Institute for Government calculations and OBR Economic and Fiscal Outlook: March 2021.

Sticking to the letter of the triple lock and making the Universal Credit 'temporary' uplift permanent would, on their own, use up most of the money the chancellor has to spend. This is before he considers allocating any additional spending to tackle the backlogs that have built up during the pandemic or to address the long-term costs of dealing with Covid-19. The prime minister's ambition to "fix" social care would cost even more.

This suggests the chancellor may well need to look for ways to increase tax revenues if he wants to meet all these pressures. Previous Institute for Government research has highlighted the importance of packaging tax rises with the 'giveaway' that they facilitate – in this case, for example, announcing tax rises at the same time as more social care spending.[37] Doing so can help build support for the change. A recent notable failure of packaging took place in 2016, when George Osborne made pension benefits for the self-employed more generous but did not announce any tax increase.[38] In March 2017, Philip Hammond attempted to raise self-employed NICs (the so-called 'white van man tax') modestly, but without being able to package this tax increase with the benefits increase he was forced into an infamous U-turn.[39]

Our work has also highlighted the importance of rolling the pitch for any tax changes, starting a public discussion early to build understanding of the changes and develop a coalition of support. Time is running out to start laying the groundwork for the tax rises that will be needed to pay for ambitions like fixing social care.

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September 2021

The Institute for Government is a registered charity in England and Wales (No.1123926) with cross-party governance. Our main funder is the Gatsby Charitable Foundation, one of the Sainsbury Family Charitable Trusts.