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Carl Emmerson
Isabel Stockton

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Copy-edited by Judith Payne

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Executive summary

The Energy Price Guarantee was announced to Parliament without any government estimates of what its cost might be. In the 'mini-Budget' on Friday 23 September, the government is expected to confirm substantial tax-cutting measures reflecting the new Prime Minister Liz Truss's commitments during the leadership campaign. Despite this – and despite the fact that the outlook for the economy is now much weaker than forecast by the Office for Budget Responsibility (OBR) in March – this statement will not be accompanied by new official forecasts for the economy and the public finances. This is disappointing.

Key findings

1. The OBR last made a forecast of the public finances back in March. Since then, energy prices and inflation have risen well beyond what was expected, and growth forecasts have slumped. We are forecasting the public finances here based on Citi's latest forecast for growth, inflation and interest rates. This implies a shorter and shallower recession than the Bank of England forecast in August, owing to the substantial support provided to household and business finances by the Energy Price Guarantee. In addition, the rise in the outlook for inflation since March cushions some of the hit to the cash size of the economy – which matters more than its real size for government receipts. Nevertheless, Citi forecasts that the cash economy will be 2% smaller in 2026–27 than the OBR forecast in March.

2. The fiscal cost of the Energy Price Guarantee is highly uncertain not least because the eventual cost will depend on the path of energy prices and, relatedly, whether the scheme is extended in some form. We assume the Energy Price Guarantee will cost well over £100 billion over the next two years, but that it will then be removed as per the government's stated plan. It could be much more expensive and end up running for more than two years – or much cheaper than we assume.

3. The cost of reversing the recent rise in rates of National Insurance contributions, and cancelling next April's planned large rise in the rate of corporation tax, is far more certain. Together Ms Truss's tax commitments, if carried out in full, would lead to revenues being about £30 billion a year lower than they would otherwise have been. Since these are large and permanent measures, they also matter more for the long-run health of the public finances than the eventual cost of the Energy Price Guarantee.

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4. Higher inflation will also push up spending on debt interest, state pensions and most working-age benefits. In contrast, spending on public services is set in cash terms, and therefore does not automatically adjust in the light of increased inflation. Previous IFS research has suggested that an additional £18 billion would need to be found in each of the next two years to restore public service spending plans to the real-terms generosity that was intended when the plans were set. In addition, Ms Truss has committed to increasing defence spending to 3% of national income by the end of the decade. Our forecasts do not include any top-up to public service spending plans that were set a year ago; hence there is considerable risk that borrowing will end up higher than our headline estimates suggest.

5. The combination of higher spending and substantial tax cuts leaves borrowing running at a much higher level than forecast in March. Importantly, even once the Energy Price Guarantee is assumed to have expired in October 2024, our forecast has borrowing running at about £100 billion a year, over £60 billion a year higher than forecast in March. Almost half of this increase in borrowing would be due to the new tax cuts. At around 3.5% of national income, borrowing would be not far off double the 1.9% of national income that it averaged over the 60 years prior to the global financial crisis, when growth prospects were considerably higher. With investment spending running at about 2½% of national income, this would leave a persistent forecast current budget deficit of around 1% of national income. Without new tax cuts, the current budget would have been forecast to remain in balance.

6. On our forecasts, debt would increase, not just while the Energy Price Guarantee was in place, but also thereafter. Persistent current budget deficits and rising debt as a share of national income means that two main fiscal targets legislated only in January would be missed and that debt would be left on an ever-increasing path. Allowing debt to rise temporarily to finance one-off packages of support, such as the Energy Price Guarantee or the furlough scheme, in exceptional circumstances is justifiable and can be sustainable, but the same case cannot be made for allowing debt to rise indefinitely in order to enjoy lower taxes now.

7. Finding a way to somehow boost the UK's rate of economic growth would undoubtedly help. But we should not underestimate the scale of the challenge: an increase in annual growth of more than 0.7% of national income – the increase required just to stabilise debt as a share of GDP at the very end of our forecasts – would be equivalent to the difference between the growth the UK experienced between 1983 and 2008 and that experienced in the 2010s. There is no miracle cure, and setting plans underpinned by the idea that headline tax cuts will deliver a sustained boost to growth is a gamble, at best.

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1. Introduction

Since the most recent official forecast in March, the economic outlook has deteriorated materially. Supply constraints and the war in Ukraine have fuelled inflation to rates not seen in the UK in 40 years, squeezing household incomes. Policy interventions on a historic scale have been announced in response, with the most significant being the new Energy Price Guarantee. Liz Truss, the new Prime Minister, has separately promised a large package of permanent tax cuts and that defence spending – at least by 2030 – should be significantly higher. All of this has enormous implications for the UK economy and public finances.

Despite this, the Chancellor's 'mini-Budget' on Friday 23 September will not be accompanied by new official forecasts for the economy and the public finances. This is disappointing. Therefore, in this report, we consider first the changing economic outlook (Section 2) and then the policy changes announced and promised since the last official OBR forecast in March (Section 3). We then consider the implications of these for tax revenues and public spending (Section 4) and borrowing and debt (Section 5). Section 6 provides a brief conclusion.

2. Changing outlook for the economy

In August, the Bank of England forecast a recession, with the economy starting to contract at the end of this year and not returning to growth until the middle of 2024 – a material deterioration from previous forecasts.

On 8 September, Ms Truss announced a huge intervention in energy policy. Household energy bills are to be capped substantially below expected market rates for up to two years, with 'equivalent' support being provided to businesses, charities and public sector organisations for six months. At the time of writing, ongoing support for businesses as well as many of the details of the overall policy are yet to be outlined. The difference between the 'shadow' price of energy – determined in wholesale markets – and the capped price for households will be paid for by the government. While the ultimate cost of the policy is inherently uncertain, this looks to be the largest package of temporary support set out in any single UK government announcement since the Second World War.

This intervention will substantially reduce the near-term peak of measured inflation and, by cushioning the impact of the rise in energy prices on households and businesses, lead to a much shallower recession. Whereas the Bank of England in August expected the economy to be smaller in real terms in 2024–25 than it had been in 2021–22, the latest forecast from Citi suggests it will grow – albeit at a still rather dismal cumulative 1.9% – over the same three-year period. This would be a much worse performance than forecast by the Office for Budget

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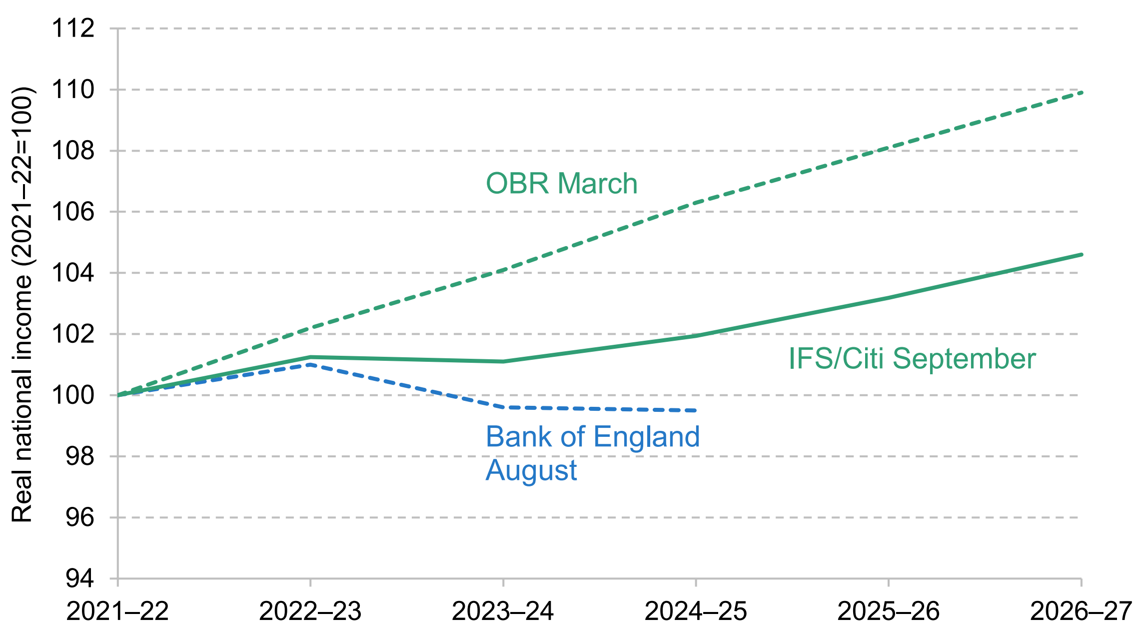
Responsibility (OBR) in March; under Citi's forecast, real GDP in 2026–27 would be 5% smaller than forecast by the OBR in March.[1]

While measured inflation is now forecast to peak at a much lower rate than prior to the announcement of the Energy Price Guarantee, it is still forecast to run at a much higher rate than forecast in March. Under Citi's forecasts, the weaker outlook for the *real* economy (as shown in Figure 1) combined with economy-wide inflation being forecast to run at a higher rate would leave the cash size of the economy at roughly the same size as thought by the OBR back in March, as shown in Figure 2. By 2026–27 the Citi forecast is for the cash size of the economy to be just under 2% lower than forecast by the OBR in March.

Figure 1. Real growth in national income: outlook much improved on August, but still much worse than forecast by the OBR in March



Source: Office for Budget Responsibility, Economic and Fiscal Outlook, March 2022; IFS/Citi calculations.

Since taxes are levied on nominal rather than real amounts (most importantly, earnings, profits and household spending), this will cushion the impact of very meagre economic growth on government revenues. In contrast, plans for spending on public services are set in cash terms and not automatically adjusted for higher inflation. If the government does not step in to top them

[1] In some part, this reflects a long-standing difference in judgements about the medium-term real growth outlook, not just the impact of the recent crisis. Back in autumn of 2021, Citi already expected cumulative real growth over the four years to 2024–25 to be 0.4% of national income lower than the OBR did. However, this accounts for only a small part of the difference between the OBR's March forecast and Citi's current one.

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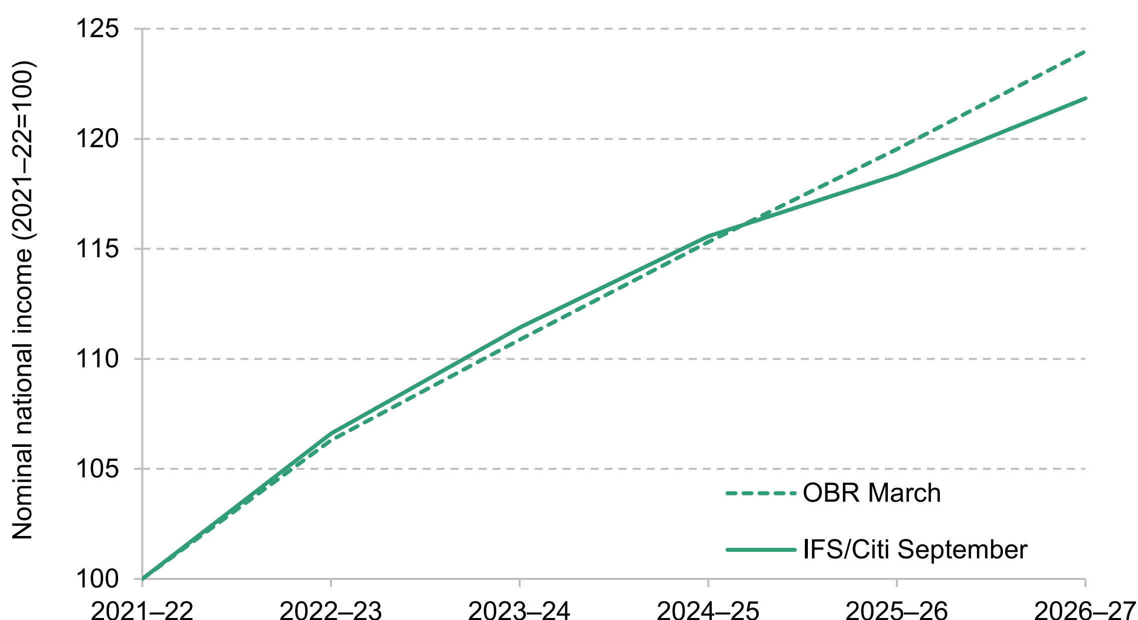
up, high inflation means they will be much less generous in real terms than intended at the time they were originally set – back in the Autumn 2021 Spending Review – implementing 'unintended austerity'.[2]

Figure 2. Nominal national income: higher inflation means that despite weaker real growth the cash size of the economy may not be that different from that forecast by the OBR in March



Source: Office for Budget Responsibility, Economic and Fiscal Outlook, March 2022; IFS/Citi calculations.

3. Changing policy settings

Related to the material changes to the economic outlook, there have been two packages of substantial additional support announced since March, first by the then Chancellor Rishi Sunak in May 2022 and then by Ms Truss in September 2022. In addition, Ms Truss made substantial commitments to implement tax cuts as part of her pitch to become Conservative Party leader. These are expected to be confirmed in the 'mini-Budget' on Friday 23 September. The likely impact on government revenues and spending from these policies is set out in Table 1.

[2] See B. Zaranko (2022), 'The inflation squeeze on public services', https://ifs.org.uk/articles/inflation-squeeze-public-services.

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Table 1. New substantial policies announced or expected since March

	Cost/revenue included in scenarios
May 2022 package	
Household energy support package	£15bn in 2022–23 (limited impact thereafter).
Energy profits levy ('windfall tax')	In force since May 2022. Initially expected to raise £5bn, this may now rise to £7bn.
Energy Price Guarantee (September 2022)	
Total	Highly uncertain and depending on both the evolution of prices and details of the policy yet to be set out, possibly well over £100bn over two years.
Of which: Household element	In place until end of 2024. We use Resolution Foundation estimates suggesting a total cost approaching £120bn, peaking at almost £60bn over the next six months (see Table 2).
Business element	We use a Citi estimate of £40bn in 2022–23, produced prior to any details of the scheme being available. Nothing included thereafter as no details of the scheme to follow are yet available.
New tax measures expected	
Reverse recent rise in rates of National Insurance contributions (NICs)	Assumed from January 2023, £14bn/year in today's terms by 2026–27.
Cancel the planned rise in the rate of corporation tax from 19% to 25% scheduled for April 2023	From April 2023, £15bn/year in today's terms by 2026–27.
Potential, not included in our forecasts	
Reverse NICs rise compensation for public sector employers	*Reduction* in spending of slightly under £2bn/year.
Bring forward cut in basic rate of income tax	From April 2023, £5bn in 2023–24 with no cost thereafter.
Abolish soft drinks industry levy	£0.4bn/year.
Increase defence spending to 3% of national income by 2030	Increasing spending from 2% to 3% of GDP would cost about £25bn/year in today's terms.

Note: Revenue for energy profits levy assumed proportional to oil and gas revenues based on futures and August 2022 NSTA oil and gas production forecasts.

Source: Authors' calculations using: A. Corlett, J. Leslie, J. Marshall and J. Smith (2022), 'A blank cheque', Resolution Foundation briefing, https://www.resolutionfoundation.org/app/uploads/2022/09/A-blank-cheque.pdf; HMRC, 'Direct effects of illustrative tax changes bulletin (June 2022)', Office for Budget Responsibility, Economic and Fiscal Outlook, October 2021 and March 2022; and the latest Citi macroeconomic forecasts.

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While planned tax cuts will have a larger impact on medium-term borrowing, in the short run the biggest change by far relative to the official March forecast is the Energy Price Guarantee. Average household energy bills will be capped at £2,500, with the government paying suppliers the difference between this new, fixed cap and a 'shadow' price cap – something akin to the usual Ofgem cap reflecting movements in the wholesale price of energy, although many details of the Guarantee's operation have yet to be determined. In addition, there is a promise that 'equivalent' support will be provided for businesses, charities and public services for six months, with some more targeted follow-up support for vulnerable sectors thereafter. The eventual fiscal cost of the scheme is inherently difficult to anticipate and will depend on the evolution of wholesale prices, details of the scheme, and future policy decisions (which themselves will likely depend on how wholesale prices evolve).

Two weeks ago, in response to the Guarantee being announced in Parliament, we highlighted the huge uncertainty over the cost of the policy and suggested that the household element might cost £60 billion in the first year and that the overall package was likely to cost over £100 billion in the first year alone.[3] For comparison, over 18 months the Coronavirus Job Retention Scheme for furloughed employees had a gross cost of £70 billion,[4] with the support for the self-employed over this period totalling a further £28 billion.[5]

Table 2. Illustrative costings for the household Energy Price Guarantee

	Lower prices (£1,000 per household lower)	Central prices	Higher prices (£1,000 per household higher)
2022–23	£30bn	£57bn	£85bn
2023–24	£24bn	£52bn	£80bn
2024–25	£0bn	£7bn	£34bn
2025–26	£0bn	£0bn	£0bn

Note: 'Lower' and 'higher' price scenarios assume that the 'shadow' (pre-Guarantee) cap would be £1,000 lower or higher, respectively, than implied by futures on 7 September, the day before the Guarantee was announced in Parliament.

Source: Central prices taken from figure 10 of A. Corlett, J. Leslie, J. Marshall and J. Smith (2022), 'A blank cheque', Resolution Foundation briefing, https://www.resolutionfoundation.org/app/uploads/2022/09/A-blank-cheque.pdf.

[3] See S. Adam, I. Delestre, C. Emmerson, P. Johnson, H. Karjalainen and P. Levell (2022), 'Response to the Energy Price Guarantee', https://ifs.org.uk/articles/response-energy-price-guarantee.

[4] Source: B. Francis-Devine, A. Powell and H. Clark (2021), 'Coronavirus Job Retention Scheme: statistics', House of Commons Library, CBP-9152, https://researchbriefings.files.parliament.uk/documents/CBP-9152/CBP-9152.pdf.

[5] Source: https://www.gov.uk/government/statistics/self-employment-income-support-scheme-statistics-december-2021.

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The Resolution Foundation subsequently costed the household element at a somewhat higher £73 billion in the first year, with a further £49 billion over the following five quarters.[6] For our central forecast, we use this costing for the household element, adding another £40 billion for the business element – with this costing being provided by Citi prior to details of this scheme being announced – all accruing in the first year. Table 2 shows the wide range of costs that might arise if 'shadow' annual bills for the average household turned out £1,000 higher or lower than expected – not an implausible range given highly volatile wholesale prices and huge uncertainty about their global determinants.

The new government's intention to delink the cost of electricity for consumers from that of gas prices would also lead to lower electricity prices in the near term, thereby reducing the cost of the Energy Price Guarantee. Estimates from Citi suggest this could reduce the overall cost of this policy by as much as £20 billion, but again there is considerable uncertainty around this estimate. The key point – to which we return later – is that whatever the ultimate cost of the Energy Price Guarantee, it is (intended to be) temporary, and should be thought of separately from any permanent changes in tax or spending, which matter much more for the long-run sustainability of the public finances.

Ms Truss has also committed to two substantial tax cuts which taken together would, if implemented in full, lead to revenues being about £30 billion a year lower than they would otherwise have been. These are:

- Reverse the rise in the rates of National Insurance contributions (NICs) that came into effect in April 2022 (and abolish the health and social care levy that was due to replace this NICs rise from April 2023). We assume that this will apply to employees, employers and the self-employed (i.e. all of the rate rises that occurred in April) and that it will come into effect on 1 January 2023. This will reduce revenues by about £14 billion a year. When the rise was introduced, public service spending plans were topped up to cover the cost of this measure to public sector employers. We assume that this compensation is not reversed; if it was then it would lower spending by almost £2 billion a year. We also assume the abolition of the health and social care levy does not lead to any change in spending on health or social care.
- Cancel the planned rise in the rate of corporation tax from 19% to 25% that is currently scheduled to come in from April 2024. This will forgo about £15 billion a year in revenue in today's terms.

[6] A. Corlett, J. Leslie, J. Marshall and J. Smith (2022), 'A blank cheque', Resolution Foundation briefing, https://www.resolutionfoundation.org/app/uploads/2022/09/A-blank-cheque.pdf.

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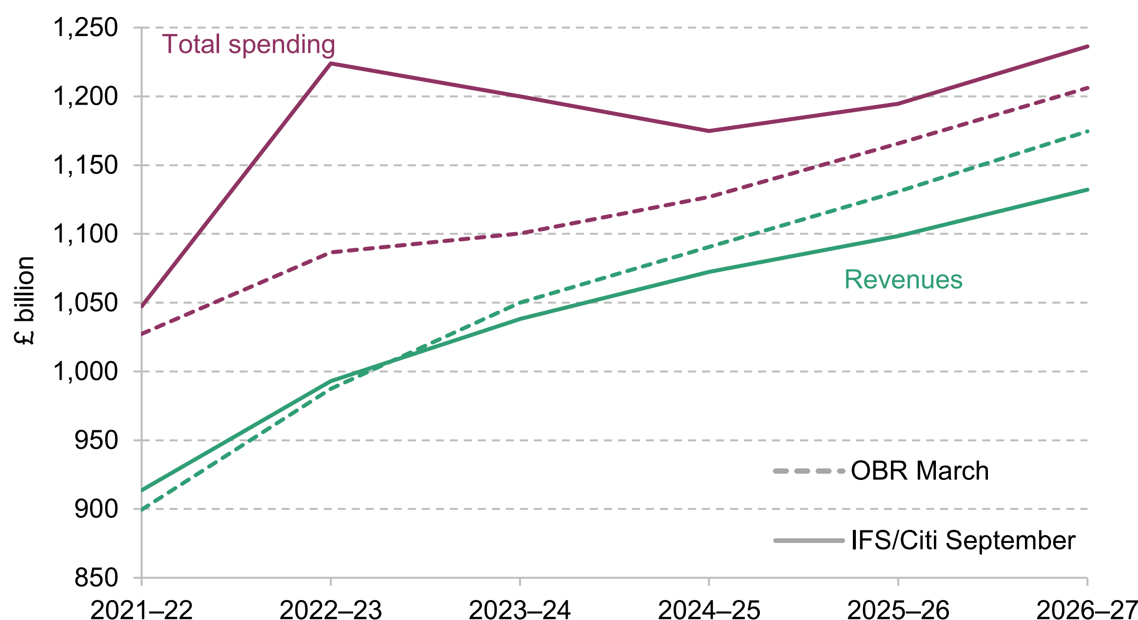
4. Implications for tax revenues and spending

With the cash size of the economy only modestly below what the OBR forecast back in March, absent these new tax cuts, revenues would similarly be expected to be only slightly lower than previously forecast (Figure 3). However, the large tax cuts that are expected to be announced by the new government permanently reduce government revenues and put taxes and social security contributions as a share of national income on a modestly falling path (Figure 4). This is not temporary support in a moment of crisis, when higher borrowing can be justified to prevent a temporary shock causing unnecessary long-term economic damage, but a permanent tax cut. It comes after a substantial rise in taxes as a fraction of national income since the pandemic, when revenues held up relatively well given the damage to the economy, and substantial discretionary tax rises introduced by the then Chancellor Rishi Sunak in an effort to consolidate the public finances (while increasing spending on health and social care, and not cutting spending in other areas). Despite this trend now beginning to reverse, taxes and social security contributions are still forecast to amount to more than 35% of national income at the end of the forecast period, their highest sustained level seen in the UK (Figure 4).

Figure 3. Receipts down and spending up



Source: Office for Budget Responsibility, Economic and Fiscal Outlook, March 2022; authors' calculations.

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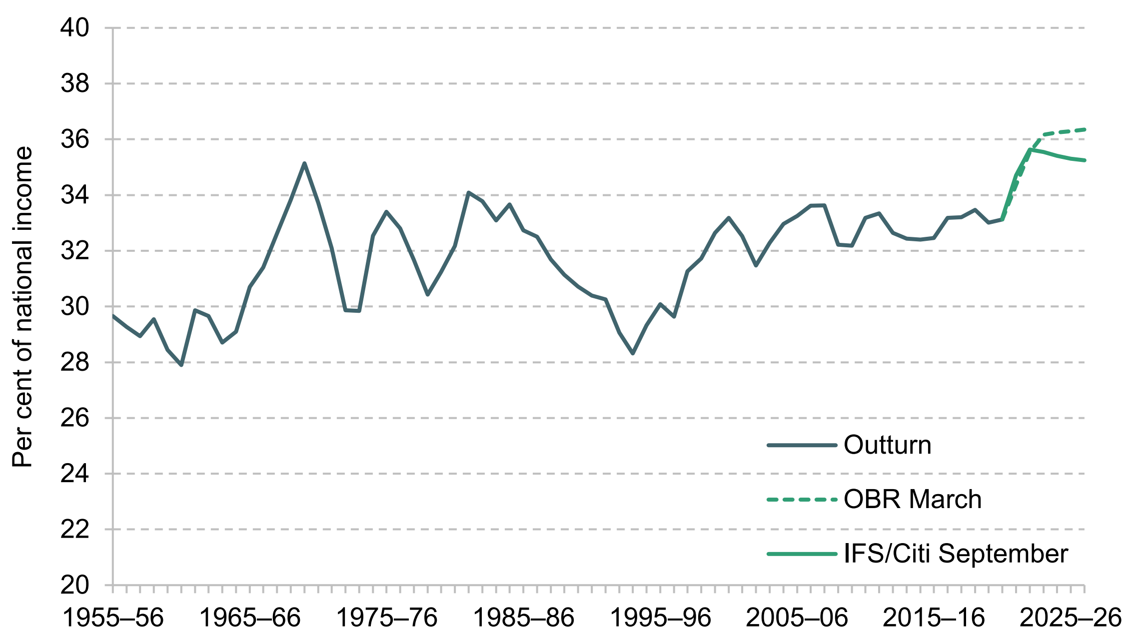
Figure 4. Taxes and contributions as a share of national income to fall, but to remain at levels not previously sustained in the UK



Source: Office for Budget Responsibility, Public Finances Databank, https://obr.uk/data; authors' calculations.

On the spending side, the most significant development is the Energy Price Guarantee which – as set out above – will add considerably to spending over the two years from October 2022. However, this is – at least, according to currently stated policy – a temporary crisis intervention and its impact on spending (and thus borrowing) will expire after that.

To date there has not been any announcement of a top-up to departmental spending plans to help public services cope with rising costs, such as fuel costs, or to fund the fact that public sector pay awards are coming in much higher than was expected at the time of the Autumn 2021 Spending Review. Keeping to the previously set cash spending plans when inflation turns out to be higher than expected is delivering less generous real-terms spending plans – i.e. a hidden spending cut. Previous IFS research has suggested than an additional £18 billion would need to be found in each of the next two years to restore public service spending plans to the real-terms generosity that was intended when the plans were set.[7]

In contrast, some other parts of government spending respond automatically to higher inflation, notably spending on pensions and other social security benefits, and on debt interest. Higher than previously forecast inflation in September will push up the cash rates of state pensions and

[7] B. Zaranko (2022), 'The inflation squeeze on public services', https://ifs.org.uk/articles/inflation-squeeze-public-services.

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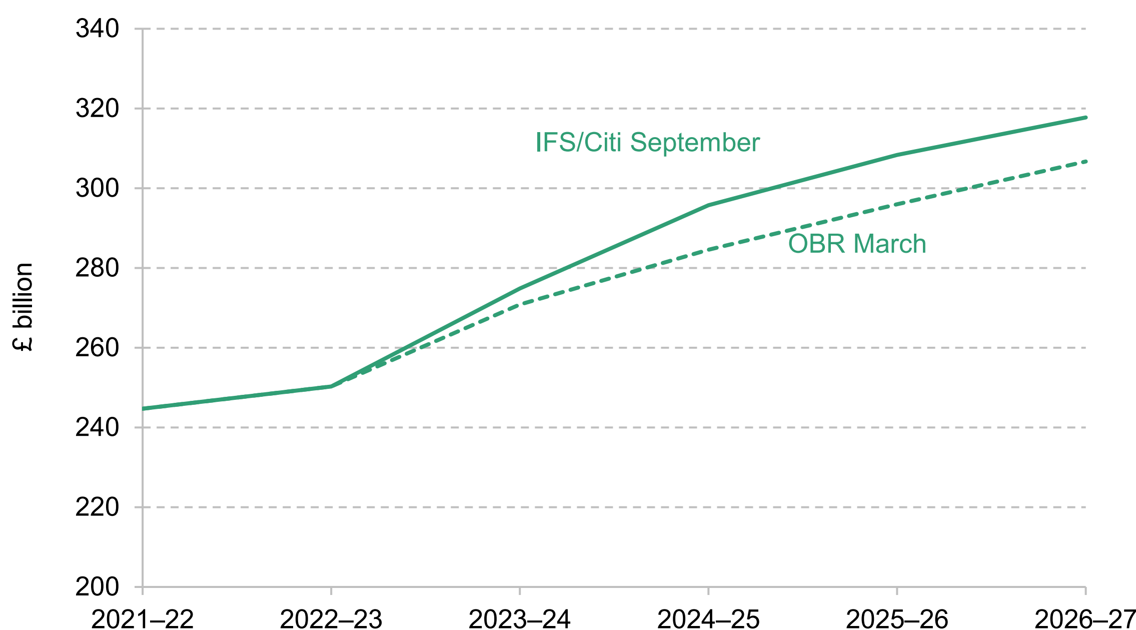
most working-age benefits next April. With higher inflation expected to persist for longer, this will also lead to substantial cash increases in most benefits and state pensions in April 2024. Figure 5 shows spending on pensions and working-age benefits under the OBR March forecast, and the additional spending that we would expect given higher inflation, which – albeit with a delay – feeds through into higher cash spending on benefits through automatic uprating. From April 2024 onwards this increases spending by slightly more than £10 billion a year.

Figure 5. Higher inflation to push up spending on pensions and working-age benefits



Source: Office for Budget Responsibility, Economic and Fiscal Outlook, March 2022; authors' calculations.

Roughly a quarter of government debt is index-linked, meaning that the cost of servicing it depends directly on inflation. This link increases spending in the short term and is the main driver of debt interest spending rising to more than £100 billion this year and remaining above £90 billion next year under our forecast (Figure 6). But payments respond to inflation, not to the price level itself. Therefore, as long as inflation falls, index-linked debt interest payments soon follow, even if the price level remains permanently elevated, which makes this – unlike the effect on spending on pensions and working-age benefits – a transitory increase in public spending.

A more long-lasting effect is due to rising interest rates as the Bank of England strives to bring inflation back towards its target of 2%. Even though the Citi scenario on which our forecasts are based includes increases in Bank Rate below current market expectations, these have a substantial and long-lasting impact on debt interest spending. Debt interest spending as a share of national income remains low in historical terms, at 2½% or less once the current peak has

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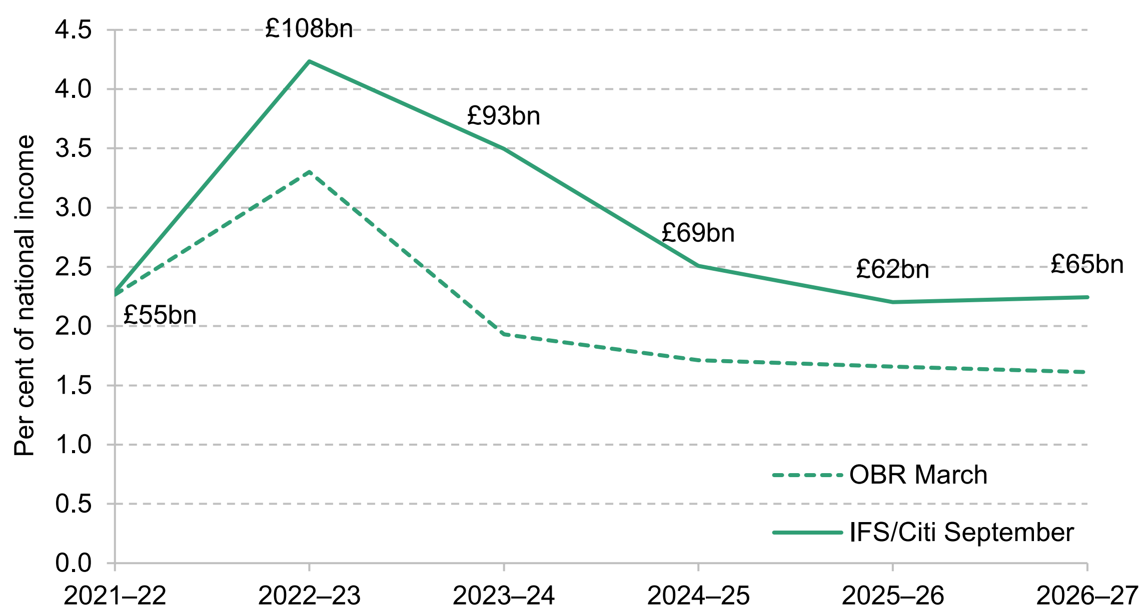
passed. But further increases in Bank Rate, or separate increases in gilt rates – the rate on government bonds – above and beyond these, would push debt interest spending up further for longer. A 1 percentage point increase in both gilt rates and Bank Rate would push up debt interest spending by over £10 billion a year.[8] Recent rapid increases in the cost of debt interest, and in gilt yields, highlight the risks of substantially and permanently increasing borrowing and putting debt on an ever-increasing path.

Figure 6. Debt interest spending forecast to remain substantially above that forecast in March, although still to return to historically low levels



Note: Central government debt interest, net of income from the Asset Purchase Facility, shown.

Source: Office for Budget Responsibility, Economic and Fiscal Outlook, March 2022; authors' calculations.

Combined, all these factors are set to increase total government spending to more than 48% of national income in the current financial year. As the impact of inflation on debt interest fades and – according to currently stated policy – spending on the Energy Price Guarantee ends, spending falls back down both in cash terms and as a share of national income. However, at the end of the forecast period, public spending remains 1.4% of national income above what the OBR predicted back in March, reflecting higher social security spending and higher interest rates as well as a smaller economy.

[8] Source: Table 3.21 of OBR, supplementary fiscal tables: expenditure, March 2022, https://obr.uk/download/march-2022-economic-and-fiscal-outlook-supplementary-fiscal-tables-expenditure/.

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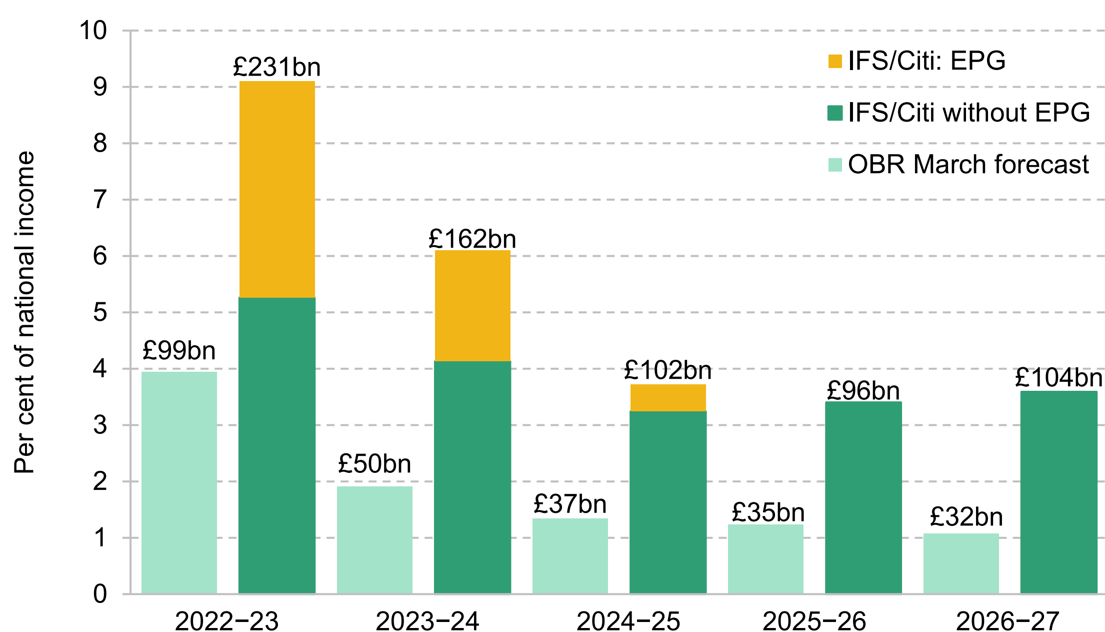
5. Outlook for borrowing and debt

Lower growth, higher spending and permanent tax cuts combine to increase borrowing substantially under our forecast (Figure 7). This year and next, the fiscal cost of the Energy Price Guarantee is inherently uncertain (which is why its direct cost is separated out in the figure), though it may push borrowing as high as 9.1% of national income this financial year – to well over £200 billion – and 6.1% in the year beginning next April. This year's figure would be the highest in the post-war period with only two exceptions: 2009–10 during the financial crisis, when borrowing reached 10.1% of national income, and two years ago, in the first year of the COVID-19 pandemic, when borrowing reached 14.7% of national income.

Figure 7. Public sector net borrowing forecast to remain substantially above March forecast



Note: EPG refers to the Energy Price Guarantee. Labels are totals under the IFS/Citi forecast, including the EPG.

Source: Office for Budget Responsibility, Economic and Fiscal Outlook, March 2022; authors' calculations.

More importantly than borrowing this year and next, the increase in spending (in cash terms) on state pensions and most working-age benefits, the increase in debt interest spending, and the large permanent cuts to taxes mean that even once the Energy Price Guarantee is assumed to have expired, borrowing is forecast to continue to run well above the level forecast in March, settling at around 3½% of national income (or around £100 billion a year). Borrowing of this level would not only be higher than forecast in March – when it was forecast to fall to just over 1% of national income or a little over £30 billion a year – but also around one-third above the

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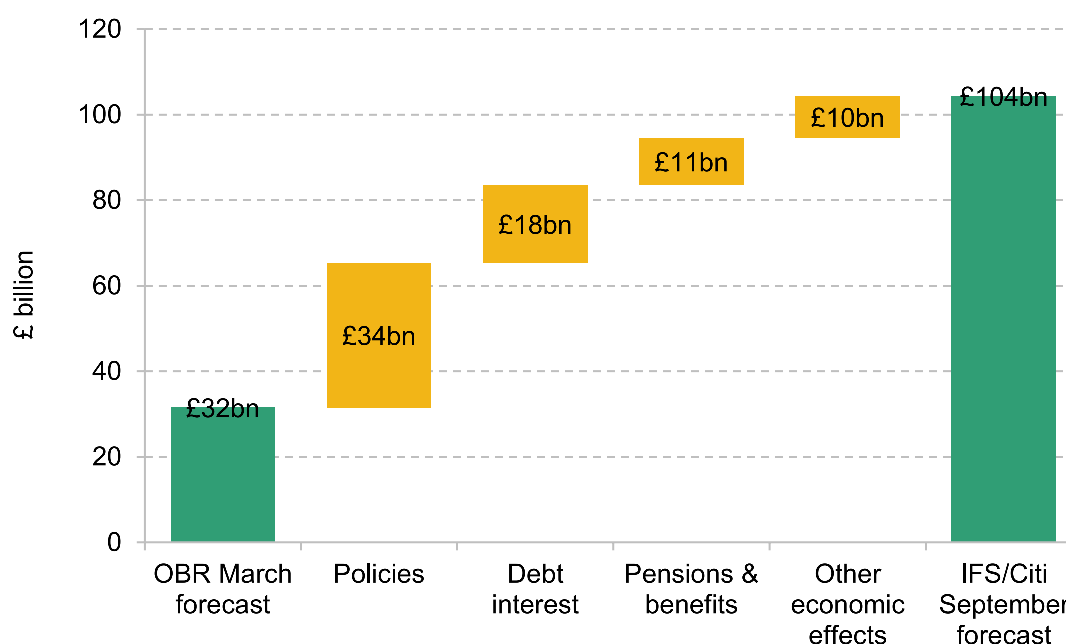
2.7% of national income a year that it has averaged in the UK over the last 74 years (and not far off double the 1.9% of national income that it averaged over the 60 years up to March 2008 – a period in which growth prospects were typically much stronger). In other words, this would mean borrowing at a historically high level on a sustained basis despite the fact that the outlook for growth is generally thought to be weaker than in the pre-2008 era. And government is now aiming to increase borrowing sharply at a time when the Bank of England is unwinding its programme of quantitative easing, which was making government borrowing even cheaper than low gilt rates suggested.

Figure 8 shows how borrowing in the last forecast year differs from the OBR's March forecast. At this point, we assume that the Energy Price Guarantee has expired and thus no longer adds to borrowing. Nearly half of the increase – £34 billion – is accounted for by discretionary policies (nearly all tax cuts, with a very small ongoing cost of the cost of living package that was announced by Mr Sunak in May). So without the package of tax cuts, borrowing would be on course to be around £70 billion in 2026–27 (or 2.5% of GDP) rather than the £104 billion (or 3.6% of GDP) shown in Figure 8.

Figure 8. Decomposing the increase in forecast borrowing in 2026–27



Note: For policies included, see Table 1.

Source: Office for Budget Responsibility, Economic and Fiscal Outlook, March 2022; authors' calculations.

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The direct impact of inflation on debt interest – via index-linked gilts – has faded out. However, debt interest remains £18 billion above the March forecast – a quarter of the total increase – reflecting higher Bank Rate feeding through to interest rates on government bonds (as was shown in Figure 6). If gilt rates were to rise by more than Bank Rate, this effect could easily be even bigger.

In addition to this, spending on pensions and working-age benefits is elevated in cash terms, reflecting the permanently higher price level (as shown in Figure 5), and lower economic growth hurts revenues – although this latter effect is cushioned by higher inflation and only accounts for 13% of the total increase.

At the 2019 general election, the Conservative manifesto outlined a number of fiscal targets, more detailed versions of which were finally legislated in January 2022. These commit to policy being set such that the current budget will be forecast to be at least in balance by the third year of the forecast. In other words, the government must aim to borrow only to invest, not to meet day-to-day spending commitments. At the last official forecast for the Spring Statement back in March, the government was meeting this target, with a forecast current budget surplus of £32 billion in 2024–25, growing slightly thereafter (see Figure 9). Under our current forecast, however, this target would be missed, and missed by quite a wide margin, with the current budget in deficit by £25 billion in 2025–26,[9] and not on a falling path due to permanent tax cuts and a weaker economic outlook. While the government could suspend the target due to the current period of exceptional events, on our forecast even in 2026–27 – i.e. well after the assumed expiry of the Energy Price Guarantee – there would still be a current budget deficit of more than 1% of national income. But absent the new tax cuts (worth more than £30 billion, as shown in Figure 8), the forecast would be for the current budget to remain in balance in 2025–26 and 2026–27.

In addition, the currently legislated version of the 'fiscal mandate' stipulates that underlying debt[10] should be falling as a share of national income by the third year of the forecast. While the Energy Price Guarantee pushes debt up sharply in the near term, it remains on an increasing path after the immediate crisis has passed (under our current forecast; see Figure 10).

[9] The 'supplementary target' counts the ongoing year as 'year zero' of the forecast. Therefore, while in March the rule applied to 2024–25, it would apply to 2025–26 if the OBR were publishing a forecast now. The precise year targeted by fiscal rules is not relevant to their purpose of aiding scrutiny and promoting sound management of the public finances.

[10] Debt excluding the Bank of England. This means excluding, for example, loans made by the Bank of England with favourable conditions to support the economy during and immediately after a crisis. It does *not* exclude the whole value of government gilts held by the Bank of England as part of its programme of quantitative easing, although the process of selling those gilts will impact somewhat on this debt measure.

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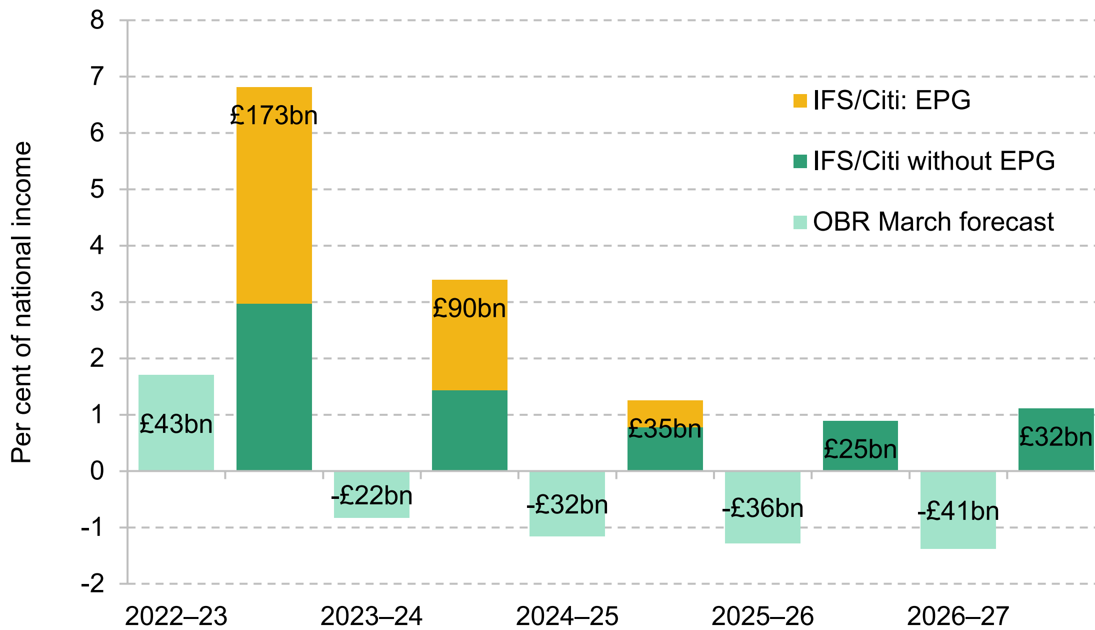
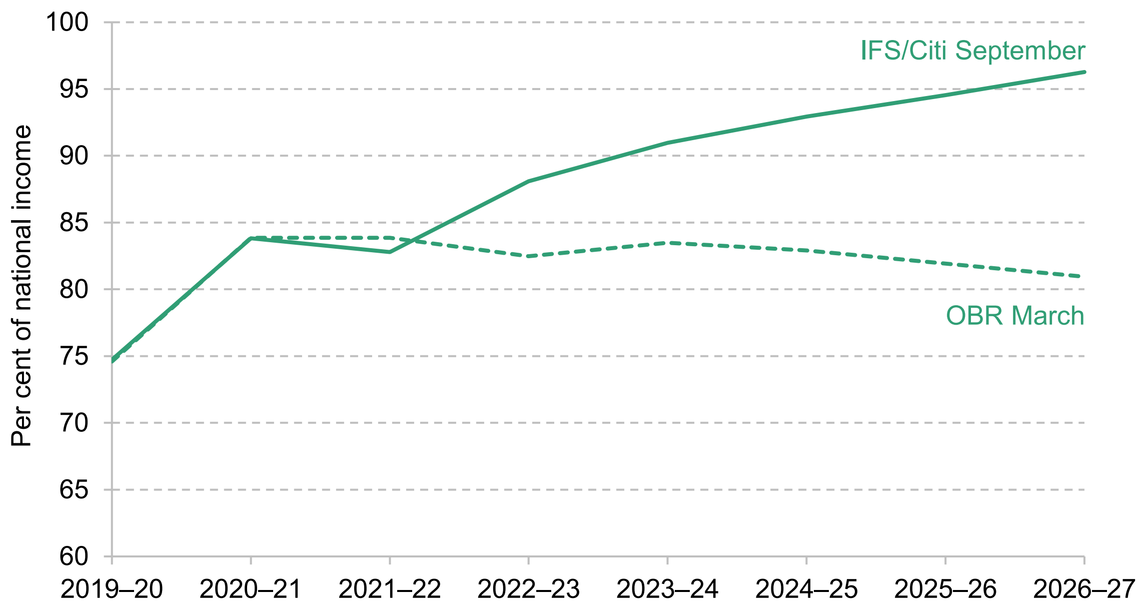
Figure 9. Current budget forecast to remain in deficit



Source: Office for Budget Responsibility, Economic and Fiscal Outlook, March 2022; authors' calculations.

Figure 10. Underlying debt forecast to rise throughout medium term



Note: Debt excluding the Bank of England shown.

Source: Office for Budget Responsibility, Economic and Fiscal Outlook, March 2022; authors' calculations.

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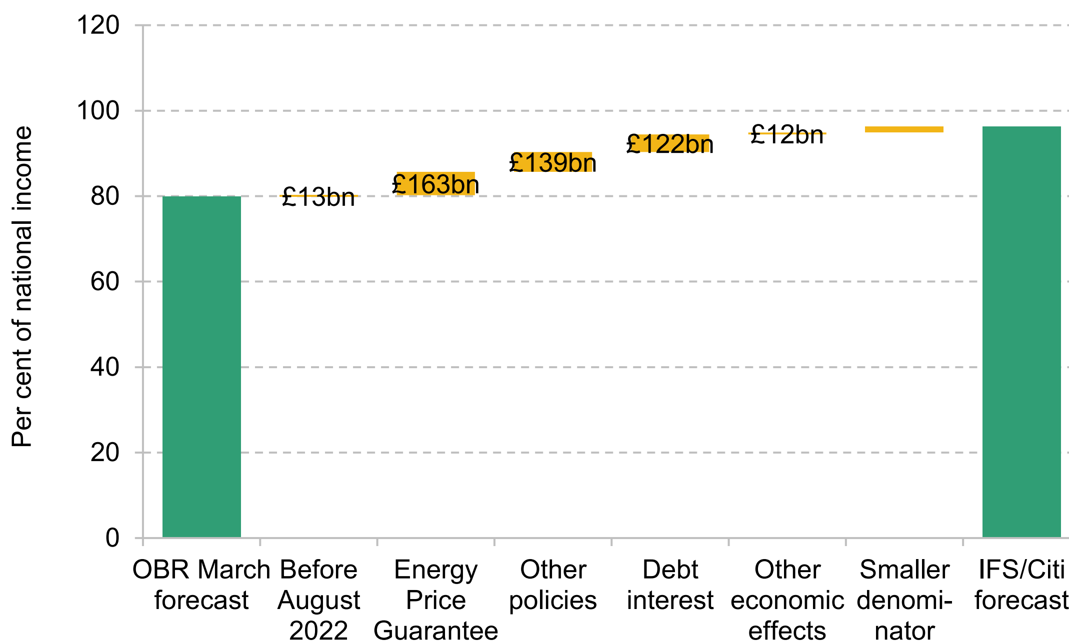
Finding a way to somehow boost the UK's rate of economic growth would undoubtedly change this picture for the better and make easier some of the trade-offs facing the Chancellor. But we should not underestimate the scale of the challenge. Even to just stabilise debt in the last two years of the forecast, the economy would have to grow an additional 0.72 percentage points in each year of the forecast going forward. To put such an increase in context: on average over the quarter of a century from 1983 to the financial crisis in 2008 the UK economy grew by 2.8% a year, whereas over the 2010s it grew by an average of just 2.0% a year. So the difference between these periods is 0.8% a year.

This shows that it might be possible that we get an extra 0.7% a year of growth, though there is absolutely no evidence that the sort of tax cuts being proposed could by themselves achieve anything like that, and the best forecasts are that we will not achieve that. Getting that scale of increase in trend growth will require either a great deal of luck over a long term or a concerted change in policy direction. We absolutely welcome the government's renewed focus on growth and hope to see the associated supply-side policies reforming tax, liberalising planning, increasing investment in education and infrastructure, and so on. But one cannot simply assume oneself to fiscal sustainability.

Figure 11. Change to forecast underlying debt as a share of national income in 2026–27



Note: 'Before August 2022' includes a higher outturn for borrowing in 2021–22 than expected in March, as well as the May cost of living package.

Source: Office for Budget Responsibility, Economic and Fiscal Outlook, March 2022; authors' calculations.

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By the end of the forecast period in 2026–27, the estimated cost of the Energy Price Guarantee accounts for an increase of 5½% of national income in forecast underlying debt – a third of the total increase (see Figure 11). Debt interest itself adds more than 4% of national income, reflecting temporarily high inflation increasing the cost of servicing index-linked debt, and higher Bank Rate pushing up government debt interest spending. Permanent tax cuts will have added 4.6% of national income – only slightly less than our central estimate of the overall cost of the Energy Price Guarantee, an exceptional crisis intervention of historic proportions, and crucially one that is intended (sensibly) to be of limited duration.

6. Conclusion

Much-increased inflation since the last official forecast in March has not only prompted a cost of living crisis, but also had a material impact on the public finances. Despite the government – so far – not stepping in to top up departmental budgets to cover increased costs, other items of spending, including on benefits and debt interest, increase automatically with higher inflation. In addition, the government's crisis response and substantial tax cuts push up borrowing – the former temporarily, the latter permanently. As a result, the set of fiscal targets that were legislated in January are already set to be missed by a wide margin, with the current budget in deficit by around £30 billion in the later years of the forecast and debt on a rising path as a share of national income, even after the Energy Price Guarantee is assumed to have expired. Substantially higher economic growth could change this picture – but generating this additional growth is an ambitious task, and there is no silver bullet in this, or any, government's arsenal to achieve it. Underpinning a set of fiscal plans with the assumption that such growth can be achieved would be a gamble, at best.

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