Spring Statement 2025: Paul Johnson's opening remarks

27 March 2025

Rachel Reeves promised that she would only have one major fiscal event each year. Yesterday she delivered on that promise. No significant tax changes. And the two substantive spending changes had effectively already been announced: the cut in ODA spending to "fund" higher defence spending, and the changes to working-age benefits. The other significant change was a shaving of assumed increases in day-to-day spending from an average 1.3% a year after 2025-26 to 1.2% a year.

The cuts to day-to-day spending, a little bit of revenue from increasing tax compliance, and an assumed boost to growth as a result of – also previously announced – planning reforms were just about enough to undo the fiscal consequences of economic and fiscal forecasts that had deteriorated since the Autumn.

In fact, as far as the Chancellor's key fiscal rule is concerned – that's the aim to be borrowing only to invest in 2029-30 – these changes weren't so much just about enough to restore us to where we were in the Autumn, they were absolutely bang on precisely enough to do so. We had £9.9 billion of headroom in October. We have £9.9 billion of headroom today. Astonishingly the numbers are within a mere £2 million of one another. It is hard to believe this is a fluke. The Treasury has clearly worked overtime to ensure that precisely the same fiscal headroom remains today as was projected in October. This is not sensible.

One can see the consequences in cuts to health-related benefits over and above those announced last week. Whilst unquestionably tough for those on the receiving end, those original cuts were defensible as a response to problems manifested by huge increases in numbers of claimants, and in spending. One could make a defence of them unrelated to the details of any particular fiscal rule. Coming back a week later with just a slightly bigger cut because that's what's needed to return the fiscal headroom to precisely where it was a few months ago risks undermining that case and discrediting attempts at genuine reform to the benefit system. If it was right last week to announce a halving of the health component of universal credit, it is hard to see why this week it is right to do more than that by halving it and then freezing it in cash terms.

I fear the Chancellor has missed the policy wood for the fiscal trees.

Despite this oh-so-careful maintenance of the fiscal headroom, the worry for Ms Reeves is that that headroom remains very small indeed. As she observed time and again, we live in a risky and changing world – as President Trump's actions overnight on tariffs demonstrates all too well. There is a good chance that economic and fiscal forecasts will deteriorate significantly between now and an Autumn Budget. If so, she will need to come back for more; which will likely mean raising taxes even further. That risks months of speculation over what those tax rises might be – a raid on pensions, a wealth tax on the richest, another hike to capital gains tax? I mention those not to commend them, far from it, but to exemplify the kinds of taxes regarding which mere speculation about increases can cause economic harm. With no sense of a tax strategy, we have no idea which way the Chancellor might turn.

Economic and fiscal forecasts

A £14 billion change in the forecast for the current budget deficit five years out is nothing special. The need for fiscal action arose not so much from a huge deterioration in the forecast as from the tiny amount of headroom left back in October.

While the Chancellor plugged that hole in the sense of getting the headroom back to the precise same level as before, she allowed herself considerably more borrowing in the interim. Total borrowing between now and 2029-30 is expected to be nearly £50 billion more than forecast in October. That's a consequence of weaker economic growth in the short run and higher spending on debt interest later on.

The OBR reckons that there is only a 54% chance that, on current policy, we will actually get to current budget balance by 2029-30. More remarkably, it puts the chances of meeting the second fiscal target, that debt (more precisely public sector net financial liabilities) should be falling in that year, even lower, at a mere 51% - a coin toss. That is despite a redefinition of debt which left much more space than the definition used until last year. Indeed, it is worth noting that the measure of debt inherited from the last government (public sector net debt excluding the Bank of England) is set to rise in every year of the forecast period.

It is the combination of "iron-clad" pass/fail numerical fiscal rules and next to no headroom against them that is causing so many problems, leaving fiscal policy completely exposed to economic developments outside the government's control. That is not conducive to a sensible policymaking process. This is not the OBR's fault. It is the product of the Chancellor's choices.

Given all the uncertainty, the OBR has not changed its view of the level of GDP in 2029-30 by very much at all. Lower growth this year is largely offset by higher growth in later years. But it does stress the sensitivity of forecasts to a range of variables.

Problems associated with interpreting recent data on GDP, productivity and the labour force make things especially uncertain. The quality of ONS data is becoming increasingly problematic for the appropriate management of the economy.

To illustrate the degree of sensitivity, if the OBR were to downgrade its view of trend productivity growth to half-way between its apparent recent level of 0.3% a year and their current forecasts of 1.25% a year that would take the forecast current budget deficit to something like £20 billion in 2029-30. There is a big downside risk here.

Departmental spending

As was already evident in October, the spending review in June is going to be tough. Changes made to spending assumptions yesterday make it slightly tougher. On average, day-to-day spending will rise by 1.2% a year from next year, rather than the 1.3% pencilled in at the Budget. Compared to October's numbers, that's a reduction of £1.2 billion in 2028-29 (the last year covered by the spending review for day-to-day spending) and of £3.6 billion in 2029-30 (the last year of the forecast, and the crucial number for the fiscal target). All that said, we can take that last number with an enormous pinch of salt. It's outside the spending review period. History suggests it will be topped up.

The spending plans are even more front-loaded than before. Spending growth is now set to be 2.5% in 2025-26, 1.8% in 2026-27 and 1.0% in each of the subsequent three years. One should always be sceptical of plans to be prudent, but only in the future. Front-loaded or not, the problem for the Chancellor is that keeping to these growth rates overall will inevitably mean cuts for some departments in the years to come.

So far, so familiar. I want to spend a bit of time, though, on the specific issue of the cut to ODA spending and the rise in defence spending.

On the face of it, it's a simple switch from one to the other: cut aid to fund defence. That is very much how the decision has been presented. But is that really the case? I ask because the composition of the ODA cut and the defence increase are very different. Almost half of the cut to ODA (£3.2 billion) is day-to-day spending that counts against the main fiscal rule. In contrast, only £0.6 billion of the increase in defence spending was day-to-day spending. That makes balancing the current budget easier, by £2.6 billion. This raises two issues.

First, in the absence of the cut to aid spending and the much smaller increase in *current* defence spending, meeting the fiscal rule by the same margin would have required bigger cuts to other departments. Because the Treasury was clearly targeting that £9.9 billion of headroom so precisely, this suggests that it was always going to target a particular level of savings from day-to-day spending. Given that, the main thing the cut to the day-to-day ODA budget seems to have achieved, apart from a cut to aid itself, is smaller cuts to other departments than would otherwise have been possible. There has been almost no switch of current spending from ODA to defence.

Second, at present, around 35% of the defence budget goes on capital spending. Yet the government has decided that more than 90% of the extra spending will go on capital. That may be the right option militarily – frankly I have no idea. But the stark difference between the capital/current split in actual defence spending and the split in the intended uplift, and the fact that the £2.6 billion 'saving' – relative I should say to a rather convolutedly constructed counterfactual – depends entirely on this pronounced focus on capital spending, does raise the question of whether the fiscal rules have influenced the composition of defence spending.

Working-age benefits

Much of what was announced on working-age benefits was not new. The key elements were set out last week by Liz Kendall, including halving the health element of universal credit for new claimants, freezing it for existing claimants and tightening eligibility criteria for personal independence payment (PIP), alongside a very seldom seen permanent increase in the basic rate of universal credit. The Chancellor yesterday added to those changes a long-term freeze to the new, lower, health element of universal credit for new claimants. She also slightly reduced the promised uplift to the basic rate of UC. Together the OBR scores a saving of £4.3 billion in 2029-30 as a result of these changes. Four observations here, more from my colleagues in a minute.

First, these changes are enough to mean that spending on health-related benefits for those of working age should, instead of rising from £37 billion in 2019-20 and £56 billion in 2024-25 to £70 billion in 2029-30, rise to "only" £65 billion in that final year. In other words, they won't lead to a cut in spending, they will slow its rate of increase.

Second, as observed at the start of these remarks, while the overall strategy is understandable, the additional cuts announced yesterday look to be there merely to meet a fiscal target. They don't give confidence in the rationality of decision making.

Third, in truth the scale of the savings is most uncertain. The OBR's costings assume almost half of those who would lose eligibility to PIP if they did not change behaviour will in fact act successfully to maintain eligibility. If people don't respond like that, savings could be higher. On the other hand, previous attempts to save money on these sorts of benefits through tightening eligibility criteria, including introducing PIP to replace the old disability living allowance, were spectacularly unsuccessful in that regard.

Fourth, the savings – and hence numbers affected – by 2029-30 are a major understatement of the long-run effects as new claimants will continue to roll on to the lower and harder to qualify for benefits, and more current PIP recipients are reassessed.

Conclusion

The changes to economic and fiscal forecasts yesterday were neither terribly big nor unexpected. The main policy announcements were not new. But even where not new we did learn some things. For example, the OBR is persuaded that planning reforms will result in a lot more houses being built than otherwise, and that this will be good for growth. The scale of those effects is uncertain, but the direction is clear – these really are the sorts of policies that should help growth. The government needs to maintain its focus on such growth enhancing policies and perhaps devote less attention to fiscal fine tuning.

While maintaining – to an absurd degree of precision – her fiscal headroom from October, the Chancellor takes three risks.

First, she is going to have to navigate a tough spending review in June in which she is going to disappoint some of her cabinet colleagues by likely cutting some departmental budgets.

Second, the fine tuning of spending decisions to meet precise fiscal targets risks undermining broader objectives, for example rational reform of the benefits system and optimal allocation of defence spending.

Third, with such little headroom and such an uncertain environment, unhelpful and damaging speculation about what taxes might be increased in the Autumn could have damaging consequences, political and well as economic.