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Treasury Committee

Autumn Budget and Spending Review 2021

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The Treasury Committee

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Contacts

All correspondence should be addressed to the Clerk of the Treasury Committee, House of Commons, London SW1A 0AA. The telephone number for general enquiries is 020 7219 5769; the Committee's email address is treascom@parliament.uk.

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Inflation

The Office for Budget Responsibility states that its central forecast for the path of inflation could be too low. Since the Budget, inflation has already significantly exceeded the level forecast by the OBR in October. The Bank of England raised interest rates to bring the rate of inflation back towards its two per cent target, and is likely to increase them further. It is therefore likely that by the next economic forecast, the Chancellor may be faced with significantly higher interest costs than those included within the October economic forecast.

The Office for Budget Responsibility forecast states that the policy mix chosen by the Chancellor at this Budget will act as a boost to inflation, and it identified in particular the increase in employer National Insurance Contributions, and the large fiscal loosening that took place in the Spending Review. The Prime Minister has advocated high wage growth. As the OBR has shown, there may be some fiscal benefits from inflation if the source of inflation is higher domestic wages rather than from imported and domestic inflation in the price of goods. However, setting out an economic policy of promoting high wage growth that is not accompanied by increases in productivity will be inflationary, and risks contributing to a wage price spiral. The Chancellor showed in his speech that he is alert to the fiscal risks of higher inflation and higher interest rates becoming entrenched. The Treasury should keep these risks at the forefront of their thinking when designing policies at future fiscal events.

Spending Review and the overall tax burden

It was against the backdrop of the Covid pandemic that the Chancellor announced a large increase in departmental spending at this Spending Review, with real-terms increases for all departments. However, the Chancellor also declared his intention to cut taxes later in this Parliament. It already appears to be a significant challenge for the tax burden as a percentage of GDP to be lower at the end of this Parliament than at the beginning, because the Chancellor's tax rises have already been announced, and his fiscal headroom to reduce them and still meet his fiscal target is small.

It is understandable that total departmental spending is rising at present, and that the UK's tax burden will rise to levels not seen during peace time, given that the country is still in the midst of a global pandemic, which has at times shut down major sections of the economy and has placed significant demand pressure on many areas of public spending. However, not all departmental spending choices that the Chancellor made were pandemic-related. If the Chancellor wishes to be able to cut taxes later in this Parliament while still meeting his fiscal rules, he may have to identify areas of departmental spending where he can reduce spending in real terms even if this is in the face of increased demand.

Funding of adult social care

Compared to the existing adult social care framework in England of thresholds and the absence of any lifetime spending caps, the Government's new policy proposals are more generous. All individuals will now have a lifetime cap on contributions where previously there was none. In addition, many more individuals will now be eligible for means tested support. These changes are welcome.

However, when compared to the Dilnot Review's recommendations that had been legislated for but which have not yet been commenced, the Government's proposals are less generous in how they treat the means tested contribution made by local authorities. As a result, while most people will pay less as a result of the proposals overall, those who have a longer care journey and have assets of between £20,000 and £106,000 will pay far more towards their own care than they would have done under the provisions of the Care Act 2014. Even if people within this cohort do not as individuals end up needing care, they are still exposed to far greater financial risk of having to contribute £86,000 of their own money in full than would have been the case under the provisions of the Care Act 2014. It is regrettable that a such a large cohort of people are still exposed to the possibility of incurring these high costs, which make up a large proportion of their assets. Compared to the original Dilnot proposals, this will be regressive.

Universal Credit taper rate

We welcome the reduction in the Universal Credit taper rate. It will provide a stronger incentive for many to take on additional work. The additional money will be welcome for many households. However, the taper rate reduction will be of no benefit for recipients of Universal Credit who are not able to work. The Government should think carefully about how it intends to support such people, given the increases in the cost of living that are emerging.

Announcements on funding of social care

For both social care announcements, the House was asked to vote on new government policies that came with significant distributional impacts for households, without the usual distributional analysis that would be provided alongside a Budget. That was highly unsatisfactory. For major announcements such as this the Government should always provide Parliament, in good time, with the information required to enable Parliament to make an informed decision. The Government's social care plans had been under development for a number of years, and it is not clear why the necessary distributional analyses, both by region and by household, were not provided at the time the House was asked to vote. Nor is it clear why the announcements on social care were made in two distinct stages.

Budget measures pre-briefing

We are deeply concerned that the rate of the National Living Wage was disclosed to ITV in an unauthorised fashion prior to the Budget, and we agree with the Treasury that this could have caused confusion in the market as to whether the information was accurate.

The rate at which the National Living Wage is set will clearly affect some companies and sectors which have large numbers of staff at the minimum wage more than it affects others who do not. Some of those firms will be listed on the stock exchange. We therefore believe that the policy may be considered to be inside information as defined by the FCA's Best Practice Note on the Market Abuse Regulations. In addition, given that the ONS deems retrospective wage data to be market sensitive, we believe it is not unreasonable to conclude that the announcement of the change to the National Living Wage rate might have been market sensitive.

The Committee acknowledges that certain Budget measures might be released prior to the Budget, in line with the Treasury's "Macpherson principles". However, under no circumstances should market sensitive policies be able to enter the public domain in a disorderly fashion.

The Permanent Secretary to the Treasury has written to us stating the Government will review the arrangements for such policies ahead of future announcements. Given the potential opportunity for disruption that this unauthorised leak could have caused, the Government should investigate how this policy came to be leaked prior to the Budget, and should publicise its findings.

Introduction

1. The Chancellor delivered the 2021 Autumn Budget and Spending Review on 27 October 2021. The Treasury Committee held four oral evidence sessions, as follows:

- 1 November 2021: Richard Hughes, Chairman of the Office for Budget Responsibility; Professor Sir Charles Bean, Member of Budget Responsibility Committee; and Andy King, Member of Budget Responsibility Committee.

- 1 November 2021: Rt Hon. Rishi Sunak MP, Chancellor of the Exchequer; Dan York-Smith, Director, Strategy, Planning and Budget, HM Treasury; and Conrad Smewing, Director, Public Spending, HM Treasury.

- 8 November 2021: Nina Skero, Chief Executive, Centre for Economics and Business Research; Paul Johnson CBE, Director, Institute for Fiscal Studies (IFS); Dr Gemma Tetlow, Chief Economist, Institute for Government; and Torsten Bell, Chief Executive, Resolution Foundation.

- 18 November 2021: Sir Andrew Dilnot CBE, Warden at Nuffield College, University of Oxford; Sally Warren, Director of Policy at The King's Fund.

1 Economy

Fiscal rules

2. The Chancellor used the Autumn Budget and Spending Review 2021 to announce new fiscal rules. The Chancellor published a new Charter for Budget Responsibility, setting out an overall "mandate for fiscal policy" as:

> To have public sector net debt (excluding the Bank of England) as a percentage of GDP falling by the third year of the rolling forecast period.[1]

Supplemented by:

> A target to balance the current budget by the third year of the rolling forecast period.

Supplemented further with:

> A target to ensure that public sector net investment does not exceed 3% of GDP on average over the rolling forecast period.[2]

3. The Chancellor also raised the Welfare Cap to £141 billion to apply in 2024–25.[3]

4. Under the previous set of fiscal rules introduced in November 2016,[4] the primary fiscal target was focussed on the Government's annual borrowing, with a supplementary target that focused on the national debt. When we asked Andy King, Member of the Budget Responsibility Committee at the Office for Budget Responsibility (OBR), whether it made sense to have net debt as the primary fiscal rule target, he told us that it did not matter which of the two targets took precedence:

> The main thing I took away from this is that I would not get hung up on which is the primary mandate and which is the supplementary target. My take on the Chancellor's presentation was that he has a debt rule and a current balance rule, which is exactly what Gordon Brown had and exactly what George Osborne had.[5]

5. Dr Gemma Tetlow, Chief Economist at the Institute for Government, told the Committee that swapping the focus of the primary target and the supplementary target from annual borrowing to total debt had not appeared to make any difference to the policy choices made at the Budget:

> […] it was not clear to me that the choices made in this Budget were any different through having the deficit target as supplementary rather than core.[6]

1 The first forecast period for the purposes of these rolling targets will be 2022–23 through to 2026–27. The target year at the Budget is therefore 2024–25.
2 HM Treasury: Charter for Budget Responsibility: Autumn 2021 update, 27 October 2021
3 HM Treasury: Autumn Budget and Spending Review 2021, paragraph 1.6
4 HM Treasury: Charter for Budget Responsibility: Autumn 2016 update, 23 November 2016
5 Q35
6 Q271

6. In contrast to the fiscal rules in place prior to this Budget, the Chancellor did not set himself a fiscal target with a fixed end point in time. Both his debt and borrowing rules target a rolling point set three years into the forecast period. Richard Hughes, Chairman of the Office for Budget Responsibility, told us that the advantage of having a rolling target was that it gave the Chancellor more flexibility to react to changing economic circumstances:

> The advantage of having a rolling target is that when making policy you assess the situation that you are given at the time […] If the world looks radically different in a year's time than you thought—perhaps the pandemic is worse and fiscal policy needs a bit more flexibility to deal with it—it makes sense to take the world as it is given to you on the day, rather than as it was when you set the targets a year ago.[7]

7. However, within its Economic and Fiscal Outlook, the OBR stated that rolling targets do have a flaw in terms of binding a Chancellor to their own rules. They said that:

> the fact that the date for meeting [rolling targets] never arrives means that the fiscal position can progressively deteriorate. History tells us that Chancellors tend to take advantage, over successive Budgets, of the additional year to meet their targets by loosening fiscal policy, while planning a sufficiently large fiscal tightening to hit the target in the target year.[8]

Headroom against targets

8. In its October 2021 *Economic and Fiscal Outlook*, the Office for Budget Responsibility (OBR) assessed the amount of spare headroom the Chancellor has against each of his fiscal rules, and the likelihood with which the rules will be met. The OBR have forecast that the target to have public sector net debt (PSND) as a share of GDP excluding the Bank of England to be falling in the third year of the forecast is to be met with a margin of 0.6 per cent of GDP, or £17.5 billion.[9]

9. The target to balance the current budget (for it not to be in deficit) by the third year of the rolling forecast is forecast to be met with a margin of 0.9 per cent of GDP, or £25.1 billion.[10]

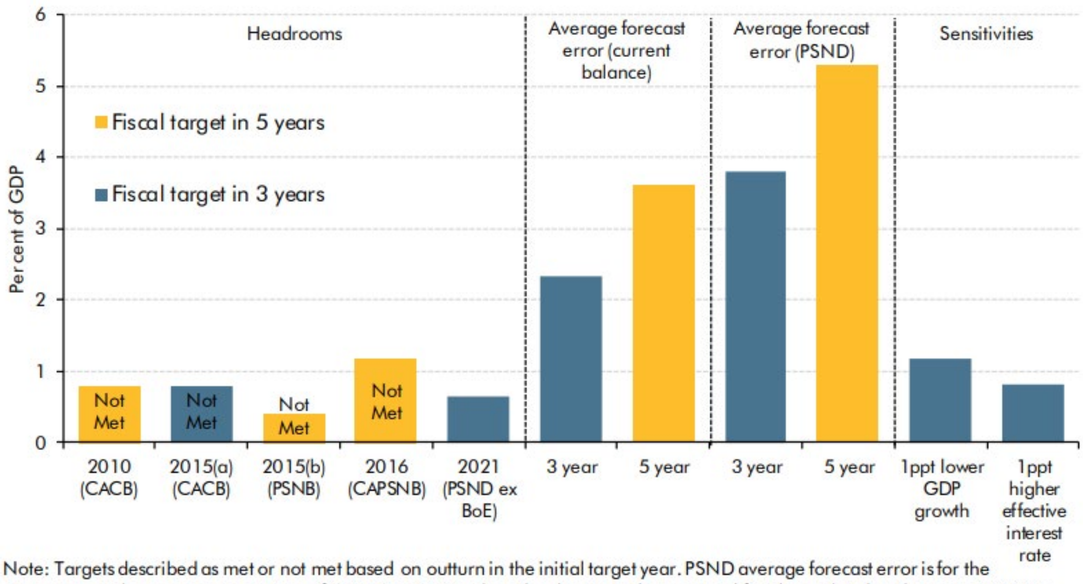
10. The OBR stated in its forecast that this headroom is smaller than that which previous Chancellors had typically given themselves. It wrote:

> The Chancellor's headroom against debt falling in 2024–25 is smaller than the headroom George Osborne gave himself when setting his first fiscal mandate in 2010 and smaller than Philip Hammond gave himself in 2016, but is larger than George Osborne gave himself when setting his second fiscal mandate in 2015. None of these previous mandates were met.[11]

7 Q38
8 OBR: Economic and Fiscal Outlook October 2021, paragraph 4.31
9 OBR: Economic and Fiscal Outlook October 2021, paragraph 1.27
10 OBR: Economic and Fiscal Outlook October 2021, paragraph 1.27
11 OBR: Economic and Fiscal Outlook October 2021, paragraph 1.28

11. The OBR also explained that the headroom the Chancellor has given himself is small when compared to previous OBR forecast errors and could therefore be used up merely through typical changes in the forecast outlook. They explained that the headroom in his net debt target of 0.6 per cent of GDP, is "only a sixth of the size of the average three-year-ahead forecast error in respect of the year-on-year change in the debt-to-GDP ratio over the past 23 years of official Treasury and OBR fiscal forecasts."[12] The OBR included a chart within its forecast to compare the Chancellor's headroom against that of previous Chancellors, and against its average forecast error:

Figure 1: OBR Chart showing headroom against fiscal targets at introduction relative to typical forecast, taken from OBR Economic and Fiscal Outlook October 2021[13]



Note: Targets described as met or not met based on outturn in the initial target year. PSND average forecast error is for the year-on-year change as a percentage of GDP. Sensitivities show the change in the proposed fiscal mandate headroom in 2024-25.
Source: OBR

The chart shows that the Chancellor's target (2021 PSND ex BoE) is smaller than previous Chancellors' targets which have not been met, and that the headroom is significantly smaller than the average of previous forecast errors. It also shows how sensitive the target is to lower economic growth, or higher rates of interest.

12. As can be seen from the chart, the OBR forecasts that GDP growth only one percentage point lower than forecast would use up all of the Chancellor's headroom against his debt target, as would a one percentage point increase in the effective rate of interest.

13. During evidence we were told that the Government is facing a number of risks which may prevent it from being able to meet its fiscal rules during the next few years. These risks include higher interest rates, higher inflation, supply chain bottlenecks, demand supply mismatches in the labour market, general threats to growth, and the course of the COVID pandemic,[14] as well as lower productivity growth.[15]

14. When we asked Professor Sir Charles Bean, Member of the Budget Responsibility Committee, what he thought might happen to interest rates and bond prices, he said that there were significant fiscal risks from rate rises:

12 OBR: Economic and Fiscal Outlook October 2021, paragraph 1.28
13 OBR: Economic and Fiscal Outlook October 2021, chart 1.9
14 Q218
15 Q64

> I am not necessarily more confident in my forecasts than the bond market forecasts—I have to say that. Markets have, over the past few months, been pricing in the risk of higher inflation. […] It would not come as a surprise to me if there was a bigger correction than many people expect, or is even priced in at the moment. It is not necessarily my central view, but I see it as a material risk.[16]

15. When we asked Paul Johnson, Director of the Institute for Fiscal Studies, what the Chancellor's options were if he found that he no longer had any headroom against his fiscal targets at the next fiscal event, he said that the Chancellor's options were not very "palatable":

> If the next time there is a Budget it looks like he is significantly out of headroom, or the OBR say he is going to miss his targets, he's got some pretty unpalatable choices. He has already put taxes up really very dramatically this year, so would he do more of that? Would he cut back on the spending numbers he has put in place this year, or miss the target? He does have a degree of space, in that he has put something like £10 billion a year into the reserve, so he could take some money out of the reserve, but I guess he is hoping that that is not what is going to happen.[17]

16. **The Chancellor's fiscal rules are reasonable in the context of the pandemic and its effects. The Chancellor has set his primary fiscal rule to target the overall stock of Public Sector Net Debt, with a secondary target to run a balanced annual current spending budget. Previous fiscal mandates had primarily targeted the annual flow of spending and focussed on the stock of debt as a secondary target. We view both of the new targets as being of equal importance, and meeting one but not the other would not constitute success.**

17. **According to the Office for Budget Responsibility, the Chancellor has between a 55 and 60 per cent chance of meeting his fiscal rules. He has given himself less room to meet his rules than his predecessors. The headroom may prove insufficient should one of the many risks to the economy crystallise.**

18. **By setting himself rolling targets the Chancellor has given himself the flexibility to respond to any deteriorations in the forecast at future fiscal events. However, the Chancellor should not use a rolling target as a mechanism to allow himself to present a series of future Budgets that promise fiscal sustainability three years into the future, but are never fiscally sustainable in the near term.**

Research and development spending target

19. At the 2020 Budget the Chancellor set out "ambitious plans to increase public research and development (R&D) investment to £22 billion per year by 2024–25".[18] The policy was described by the Treasury as supporting "research […] by cutting bureaucracy, experimenting with new funding models, and establishing a new funding agency to focus on high-risk, high-reward research".[19] The Treasury said it would be aimed at:

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16 Q20
17 Q217
18 HM Treasury: Budget 2020, 11 March 2020, paragraph 1.220
19 HM Treasury: Budget 2020, 11 March 2020, paragraph 1.220

> meeting the great challenges facing society, including climate change and an ageing population, and providing funding to pursue 'moonshot' scientific missions [by] investing in the government's own strategic science capability and improving public services [and] backing businesses to invest and innovate so that they can compete in the global technology-driven economy.[20]

20. At the Autumn 2021 Budget the Chancellor announced that the target to reach £22 billion per year spent on public R&D investment would be pushed back two years to 2026–27.[21] When we asked the Chancellor why he had decided to push the target back by two years, he said it was due to needing to balance the spending on R&D with other priorities. He said:

> The overall pie for spending on capital is large by historic standards. That said, there are lots of calls on that pie, whether it is other types of economic infrastructure like roads, rail, broadband, et cetera, or net zero or social infrastructure such as schools, hospitals or prisons. It is just balancing all of those things together and making sure that the pounds you spend are going to be well spent while still delivering on our objectives.[22]

21. Dr Gemma Tetlow, Chief Economist, Institute for Government, told us that despite the R&D target being pushed back two years, the Government's spending on R&D was still high in historical terms:

> There was slippage in when the money is going to be spent, but it is still a big increase in R&D funding in this Budget compared with where we were. That is probably the big picture that we need to retain: there is still a big uplift in R&D.[23]

22. Within the Budget red book, the Treasury state that once the government's increase in R&D spending and its reforms to R&D tax reliefs are taken into account, the "combined public direct and indirect support for R&D [will rise] to 1.1 per cent of GDP in 2024–25, well above the 2018 OECD average of 0.7 per cent".[24] In his speech the Chancellor stated that at present, Germany invests 0.9 per cent in public R&D, France 1 per cent, and the US 0.7 per cent.[25]

23. **It is disappointing that the Government has pushed back its target to spend £22 billion per year on Research and Development by two years from 2024–25 to 2026–27. However, the new commitment would still represent a significant increase and bring public UK Research and Development spending above the OECD average, and above Germany, France and the US. While the target for R&D spending remains historically high, there is a risk that at future fiscal events—as was the case with this Budget—the Chancellor will again opt to make savings by delaying the increases in R&D spending. Cutting or delaying R&D spending may be a false economy, given the hopes the**

20 HM Treasury: Budget 2020, 11 March 2020, paragraph 1.220
21 HC Deb, 27 October 2021, col274
22 Q105
23 Q230
24 HM Treasury: Autumn Budget and Spending Review 2021, page 5
25 HC Deb, 27 October 2021, col274

Government has for stimulating economic growth through its R&D spending. R&D spending is important and the Government should pursue this target with considerable determination.

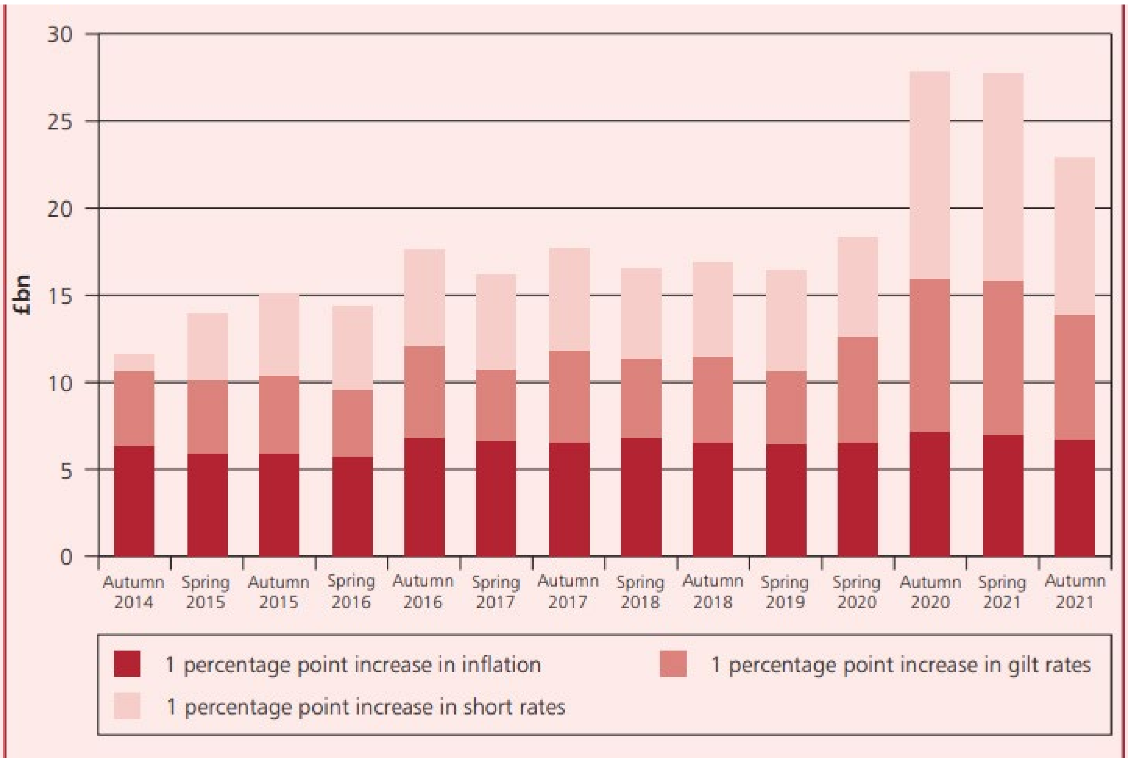
Inflation

24. Within its Economic and Fiscal Outlook, the OBR forecast that inflation will rise sharply but then return to the Bank of England target of two per cent soon thereafter. It wrote:

> In our central forecast, CPI inflation peaks at 4.4 per cent in the second quarter of 2022, with above-target inflation due to higher utility prices and rebounding demand running up against supply bottlenecks. Inflation then returns relatively quickly towards the Bank of England's two per cent target as utility prices stabilise and these supply bottlenecks ease.[26]

25. As discussed above, the OBR's Economic and Fiscal Forecast states that a one percentage point increase in inflation would be sufficient to use up all of the Chancellor's headroom against his debt target.[27] In the Budget the Treasury produced a chart setting out in more detail how sensitive the future fiscal effects from inflation, interest rates and gilt rates might be:

Figure 2: HM Treasury Autumn Budget and Spending Review 2021: Chart 1.9 Debt interest sensitivities in the final year of the forecast, by forecast event



Source: Office for Budget Responsibility.

26 OBR: Economic and Fiscal Outlook October 2021, Box 2.6
27 OBR: Economic and Fiscal Outlook October 2021, Chart 1.9

26. We asked Nina Skero, Chief Executive of Centre for Economics and Business Research (CEBR), what her views were on inflation and the OBR's inflation forecast, and she told us that she was concerned about inflation,[28] and that the wider markets had been forecasting higher inflation than the OBR for a while:

> For some time, CEBR and a lot of private sector forecasters have been forecasting inflation well above target. Based on the latest OBR estimates, those forecasts have now moved closer to what the consensus was before. I would say that we still expect slightly higher inflation than what the OBR published in its latest outlook, and we also expect it to be somewhat more persistent throughout 2022–23.[29] […] The title of our instant Budget reaction was "If inflation subsides … this Budget will look like a masterstroke", but I would say that that is a big if, and it is probably the single biggest macroeconomic indicator we should be keeping an eye on.[30]

Paul Johnson agreed, saying that "The risk around both inflation and interest rates is pretty significant".[31]

27. However, Torsten Bell, Chief Executive of the Resolution Foundation, told us that it was important to keep the risks of higher inflation in perspective. He told us that the UK was "nowhere near" the point at which interest payments would become higher than what the country was prepared to raise through taxation, and that as a result, the UK was not in any danger of going bust.[32]

28. The OBR stated within its forecast that the Budget itself will be inflationary. It wrote:

> Inflation is also boosted slightly over the next couple of years by policy announced in the Budget and Spending Review. Increased inflationary pressure from the near-term fiscal loosening and pass-through from the increase in employer National Insurance Contributions to consumer prices outweigh the downward pressure from the customary freezes in fuel and alcohol duties.[33]

29. Despite the OBR forecasting that inflation will go above the Bank of England's two per cent Consumer Price Index (CPI) target, the OBR goes on to say that its forecast for inflation may still be too low:

> While our central forecast sees inflation rise to well above the target, there is a significant risk that it may rise even higher and turn out to be more persistent.[34] […] Inflation may prove more durable, especially if people come to expect high inflation to continue and businesses raise prices to protect their profit margins or workers demand larger wage increases to maintain their purchasing power.[35]

28 Q232
29 Q232
30 Q234
31 Q238
32 Q239
33 OBR: Economic and Fiscal Outlook October 2021, paragraph 2.87
34 OBR: Economic and Fiscal Outlook October 2021, paragraph 2.89
35 OBR: Economic and Fiscal Outlook October 2021, Box 2.6

30. Since the Budget, inflation has been higher than forecast by the OBR. The OBR forecast CPI measure of inflation of 2.8 per cent in Q3, and 4 per cent in Q4.[36] The ONS states that CPI inflation in November was running at 5.1 per cent.[37]

31. Within its forecast the OBR goes into some detail on what the fiscal consequences of an increase in inflation would be. It states that the historical experience of high bouts of inflation that inflate away government debt are no longer as applicable today because whereas before 1980 there were no gilts linked to inflation indices, now 24 per cent of the Government's gilts are linked to inflation.[38] Therefore as inflation rises, so does the interest payable on these index linked gilts.

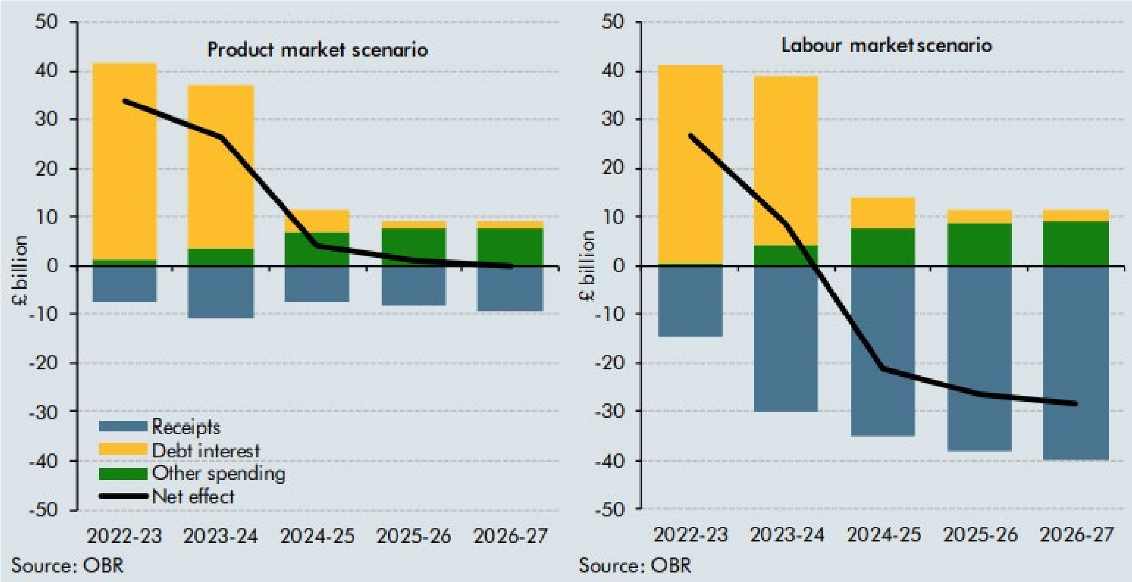
32. However, the OBR forecast also explains that the source of higher inflation has an impact on its fiscal consequences. It states: "imported inflation that reduces real wages is fiscally costly; domestically generated inflation driven by rising wages is beneficial."[39] The forecast goes into more detail setting out the mechanism through which product inflation (inflation caused by higher prices for imported goods) and labour inflation (inflation caused by increasing wages) would affect the fiscal forecast:

> In the product market scenario, cost-driven inflation requires materially higher interest rates to return inflation to target, but with limited pass-through into higher wages and consumption (and therefore income tax, NICs, and VAT). This leaves borrowing higher in the short term thanks to higher debt interest spending. Welfare spending also rises materially. But as the initial inflation and associated Bank Rate rises pass, the debt interest impact falls away. By the end of the scenario, higher receipts almost exactly offset higher spending with no net effect on borrowing. […]
>
> In the labour market scenario higher inflation is driven by stronger wage growth, raising both the price level and the labour share of national income. This lowers borrowing significantly over the medium term. While spending is broadly in line with the product market scenario, income tax and NICs receipts are much stronger thanks to higher wages. This feeds through into higher consumption (boosting VAT and excise duties) and higher houses prices (boosting stamp duty and CGT receipts). By the end of the scenario, higher receipts more than offset higher spending and borrowing is almost £30 billion lower.[40]

36 OBR: Economic and Fiscal Outlook October 2021, Chart 2.29
37 Office for National Statistics: Consumer price inflation, UK: November 2021, 15 December 2021
38 OBR: Economic and Fiscal Outlook October 2021, Box 3.2
39 OBR: Economic and Fiscal Outlook October 2021, Box 3.2
40 OBR: Economic and Fiscal Outlook October 2021, Box 3.2

The forecast shows these two outcomes in two charts:

Figure 3: OBR Chart: Public sector net borrowing effects of our alternative inflation scenarios[41]



33. The OBR also stated that increases in inflation would bring with them higher interest rates. Higher interest rates would feed through to the public finances quickly because the Bank of England has issued reserves which amount to 38 per cent of GDP, and holders of these reserves would have to be paid higher interest when the Bank Base Rate went up.[42]

34. The Chancellor himself, in his Budget speech, made it clear that he was conscious of the risks the public finances faced from higher inflation. He said:

> Our public finances are twice as sensitive to changes in interest rates as they were before the pandemic, and six times as sensitive as they were before the financial crisis. Just a one percentage point increase in inflation and interest rates would cost us around £23bn.[43]

35. The Chancellor also referred within his Budget Speech to the Prime Minister's vision as set out in his Conservative Party conference speech, in which he championed growth in wages.[44]

36. Since the Budget, the Bank of England has raised interest rates by 0.15 per cent, and at its December Monetary Policy Committee (MPC) meeting the majority of the MPC members concluded that the economic conditions had been met to make it "necessary over coming months to increase Bank Rate in order to return CPI inflation sustainably to the 2% target".[45]

41 OBR: Economic and Fiscal Outlook October 2021, Box 3.2
42 OBR: Economic and Fiscal Outlook October 2021, Box 3.2
43 HC Deb, 27 October 2021, col274
44 Rt Hon Boris Johnson MP: Keynote speech, Conservative Party Conference, 26 October 2021
45 Bank of England, Monetary Policy Summary, December 2021

37. **Due to the increase in Government debt, the proportion of gilts that are index linked, as well as the proportion of UK Government debt that has been financed through the issuance of Bank of England reserves, the public finances are highly sensitive to increases in inflation and interest rates.**

38. **The OBR states that its central forecast for the path of inflation could be too low. Since the Budget, inflation has already significantly exceeded the level forecast by the OBR in October. The Bank of England raised interest rates to bring the rate of inflation back towards its two per cent target, and is likely to increase them further. It is therefore likely that by the next economic forecast, the Chancellor may be faced with significantly higher interest costs than those included within the October economic forecast.**

39. **The OBR forecast states that the policy mix chosen by the Chancellor at this Budget will act as a boost to inflation, and it identified in particular the increase in employer National Insurance Contributions, and the large fiscal loosening that took place in the Spending Review. The Prime Minister has advocated high wage growth. As the OBR has shown, there may be some fiscal benefits from inflation if the source of inflation is higher domestic wages rather than from imported and domestic inflation in the price of goods. However, setting out an economic policy of promoting high wage growth that is not accompanied by increases in productivity will be inflationary, and risks contributing to a wage price spiral. The Chancellor showed in his speech that he is alert to the fiscal risks of higher inflation and higher interest rates becoming entrenched. The Treasury should keep these risks at the forefront of their thinking when designing policies at future fiscal events.**

2 Spending Review and the overall tax burden

40. In his Budget speech the Chancellor announced that the Spending Review would increase spending to deliver improvements in public services:

> As a result of this Spending Review […] there will be a real-terms rise in overall spending for every single department. Our stronger economy lays the foundation for everything we want to achieve in today's Budget: World-class public services and more investment in our future growth. At the start of this Parliament, resource spending on healthcare was £133bn. Today's Spending Review confirms that by the end of this Parliament, it will increase by £44bn to over £177bn.[46]

The Chancellor also stated that taxes were going up. He said:

> Taxes are rising to their highest level as a percentage of GDP since the 1950s. I don't like it, but I cannot apologise for it–it's the result of the unprecedented crisis we faced and the extraordinary action we took in response.[47]

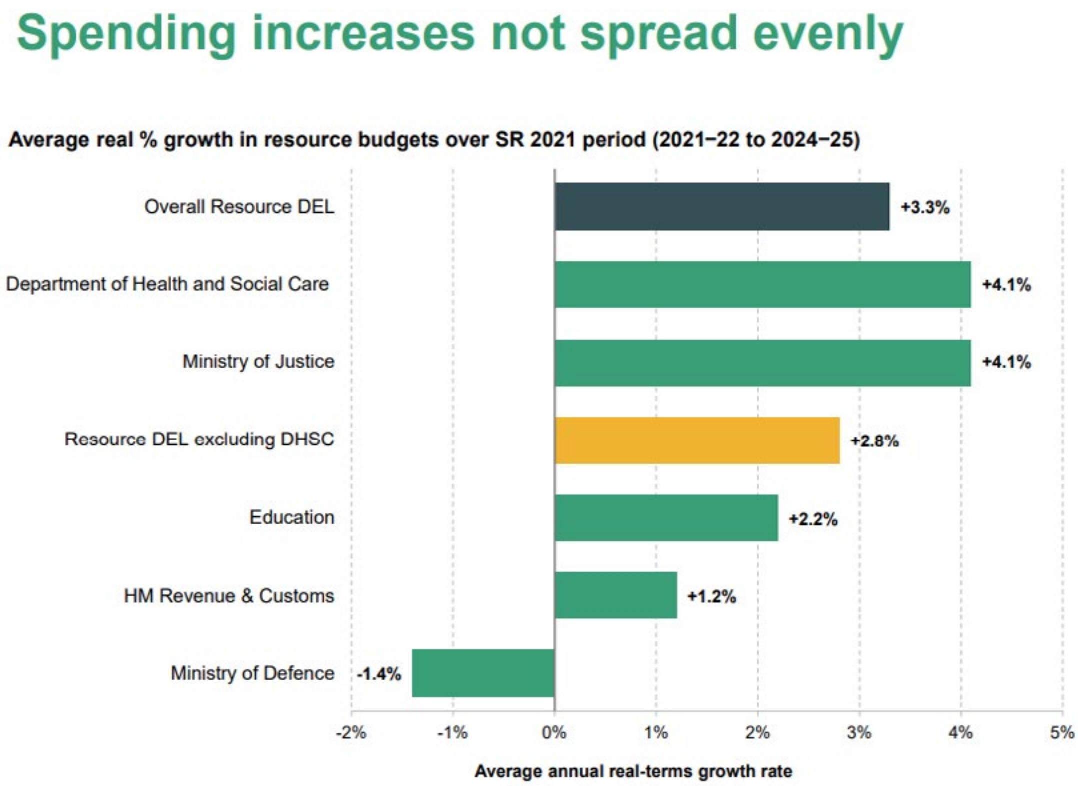
41. The first part of this chapter looks at the individual spending settlements of departments, and the cost pressures that remain. The chapter then examines the extent to which the Chancellor's decisions in the Spending Review and his decisions on the overall level of tax are related. Finally, the chapter considers the extent to which the Spending Review has delivered on the Government's Levelling Up agenda.

Individual departmental settlements

42. In its analysis of the Budget, the Institute for Fiscal Studies (IFS) showed that the increases in budgets varied across departments:

46 HC Deb, 27 October 2021, col274
47 HC Deb, 27 October 2021, col274

Figure 4: Institute for Fiscal Studies chart showing Spending Review outcomes for selected departments[48]



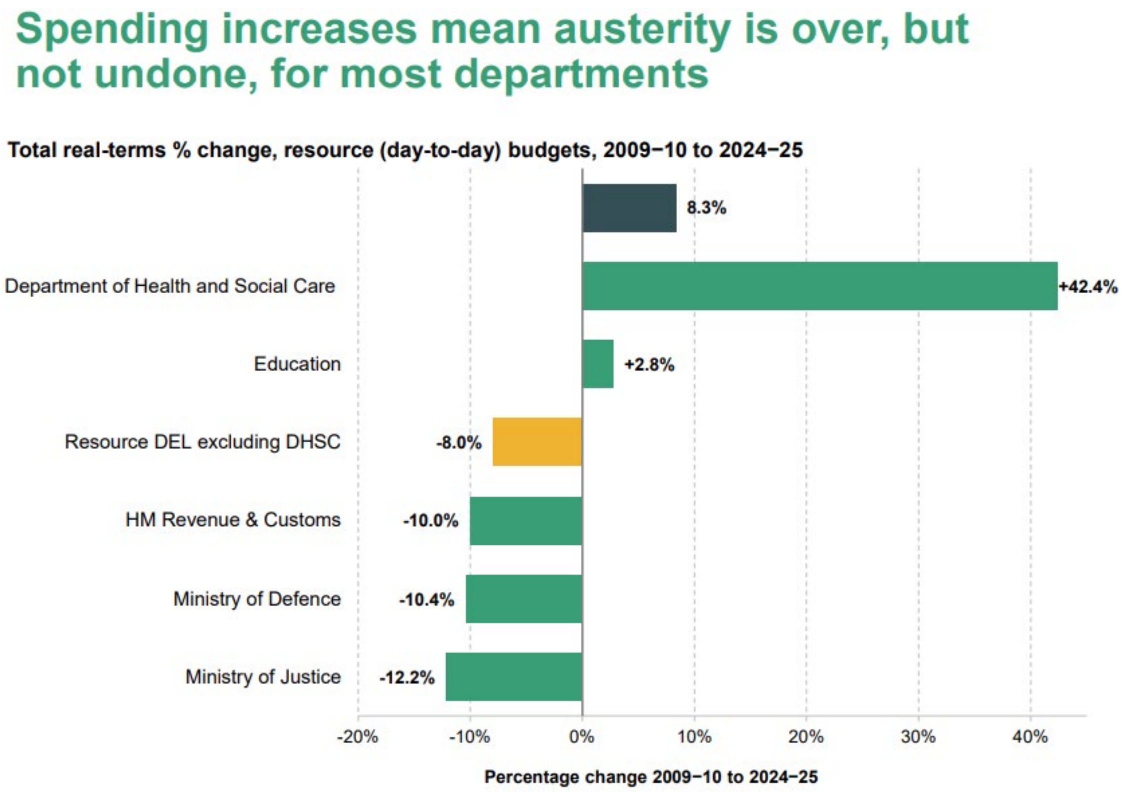
43. The Defence settlement is negative over the Spending Review 21 period. However, the Defence budget was set at Spending Review 2020, and over the whole Parliament 2019–20 to 2024–25 there will be an increase in the average annual real-terms growth of 1.5 per cent.[49]

44. The Official Development Assistance (ODA) budget was reduced to £10 billion (0.5% of GDP) in the 2020 Spending Review in December 2020.[50] In the 2021 Spending Review the ODA budget increases by 23% over the Spending Review period.[51] The 2021 Spending Review also provides £5.2 billion in contingency funding, sufficient to enable the ODA budget to return to 0.7% of GDP in 2024–25, the last year of this Spending Review, should the conditions for the return to 0.7 per cent of GDP be met.[52] The Budget states that, under present forecasts, these conditions will be met.[53]

45. The IFS also produced analysis showing that despite the increases to departmental budgets in this Spending Review, some departments still had fewer resources in real terms than they did in 2010, before the fiscal consolidation of the Coalition Government in response to the financial crisis (see Figure 5).

48 Institute for Fiscal Studies: Spending Review 2021: austerity over but not undone, 28 October 2021
49 HM Treasury: Autumn Budget and Spending Review 2021, footnote 2, page 183
50 HM Treasury: Autumn Budget and Spending Review 2021, paragraph 2.154
51 HM Treasury: Autumn Budget and Spending Review 2021, paragraph 2.154
52 HM Treasury: Autumn Budget and Spending Review 2021, paragraph 1.70
53 HM Treasury: Autumn Budget and Spending Review 2021, paragraph 1.70

Figure 5: Institute for Fiscal Studies chart showing selected departmental budget changes between 2009–10 and 2024–25[54]



46. Dr Gemma Tetlow noted the significant increase in departmental spending in the first two years of the Spending Review. She said: "one of the big news items from the Spending Review was extra money going in for the first couple of years, making more money available across several Departments for tackling some of the Covid backlog issues."[55]

47. On specific departments, she said the stand-out "winner" was the Ministry of Justice:

> The Ministry of Justice got one of the biggest settlements this time, in stark contrast to the settlements it got in 2010 and 2015. That is a clear statement from this Government on wanting to put more money into courts and the Prison Service. That deals with the knock-on impacts of recruiting 20,000 extra police officers and makes more money available for dealing with courts' backlogs and some of the pre-existing issues in the courts and prisons system.[56]

She also noted that the Department for Transport had received "quite a generous settlement."[57]

54 Institute for Fiscal Studies: Spending Review 2021: austerity over but not undone, 28 October 2021
55 Q288
56 Q288
57 Q288

48. While the Department for Education (DfE) will have received a real-terms increase in its budget of 2.3 per cent compared to 2009–10, Dr Tetlow told us that the DfE had not done as well in the Spending Review as the sector may have hoped for, given how it had been impacted by the loss of learning during the pandemic, and the need there would be for educational catch-up:

> Education was clearly one of the relative losers from the Spending Review. Certainly, the £5 billion that has gone into education isn't large enough to meet our estimate of what might be needed to catch up on lost learning. […] Poorer skills in the cohorts going into the labour market over the next few years does run the risk of having longer-term impacts on productivity.[58] […] Even though the Chancellor hailed in his speech that per pupil spending would go back to its 2010 level, it is pretty remarkable to have a decade with no real-terms growth in spending in schools. That is quite unusual and not a strong signal of prioritising improved skills in the UK.[59]

49. Paul Johnson raised concerns over the disparities between the changes in budgets between Education and Health since 2010. He told us that "It is extraordinary that while, over a much longer period, health spending has continued going up as a fraction of national income, overall, education spending has not done so".[60] He went on to say that falling educational attainment would have an impact on productivity: "a well-educated, highly skilled workforce is absolutely crucial for productivity and future living standards".[61]

50. Nina Skero agreed that there could be wider economic impacts of lower education in the long term. She said that "as the UK had restricted inward migration from the EU, it is more risky to not have the homegrown skills that you think the economy will require".[62]

51. A further area of spending which did not do so well from the Spending Review was Local Government. When compared to its pre-pandemic budget, the Spending Review allocated the Department for Levelling Up, Housing and Communities (DLUHC) Local Government budget an increase of 8.7 per cent by the end of the review period.[63] However, Dr Tetlow told us:

> [Its] spending power is going up more than it has in recent spending reviews, but once you strip out the money already ring-fenced for the increased generosity of the offer on social care, it still looks like they will have to cut services on non-children and adult social care to try to make enough money available to deal with existing pressures that were already there.[64]

52. Settlements for other departments compared to their pre-pandemic budgets included an 8.1 per cent increase for DEFRA, a 2.9 per cent increase for DCMS, and a 9.9 per cent increase for BEIS.[65]

58 Q282
59 Q288
60 Q290
61 Q290
62 Q291
63 HM Treasury: Autumn Budget and Spending Review 2021, Table 1.16
64 Q288
65 HM Treasury: Autumn Budget and Spending Review 2021, Table 1.16

53. The capital budgets for the Ministry of Defence and for BEIS will have increased from their pre-pandemic budgets by 6.8 per cent and 10.9 per cent respectively.[66]

54. **While some departments which had been significantly disrupted by the pandemic, such as the Department of Health and Social Care and the Department for Transport, received large increases, the Department for Education, which was also affected by the pandemic, did not receive such a generous settlement. School funding per head has only now returned to 2010 levels following the latest Budget.**

Overall departmental spending

55. The Autumn Budget and Spending Review 2021 executive summary sets out the overall spending envelope for departments as follows:

> Every department's overall spending will increase in real terms as a result of Spending Review 2021, and over this Parliament. Total departmental spending is set to grow in real terms at 3.8% a year on average over this Parliament–a cash increase of £150 billion a year by 2024–25 (£90 billion in real terms). This is the largest real-terms increase in overall departmental spending for any Parliament this century.[67]

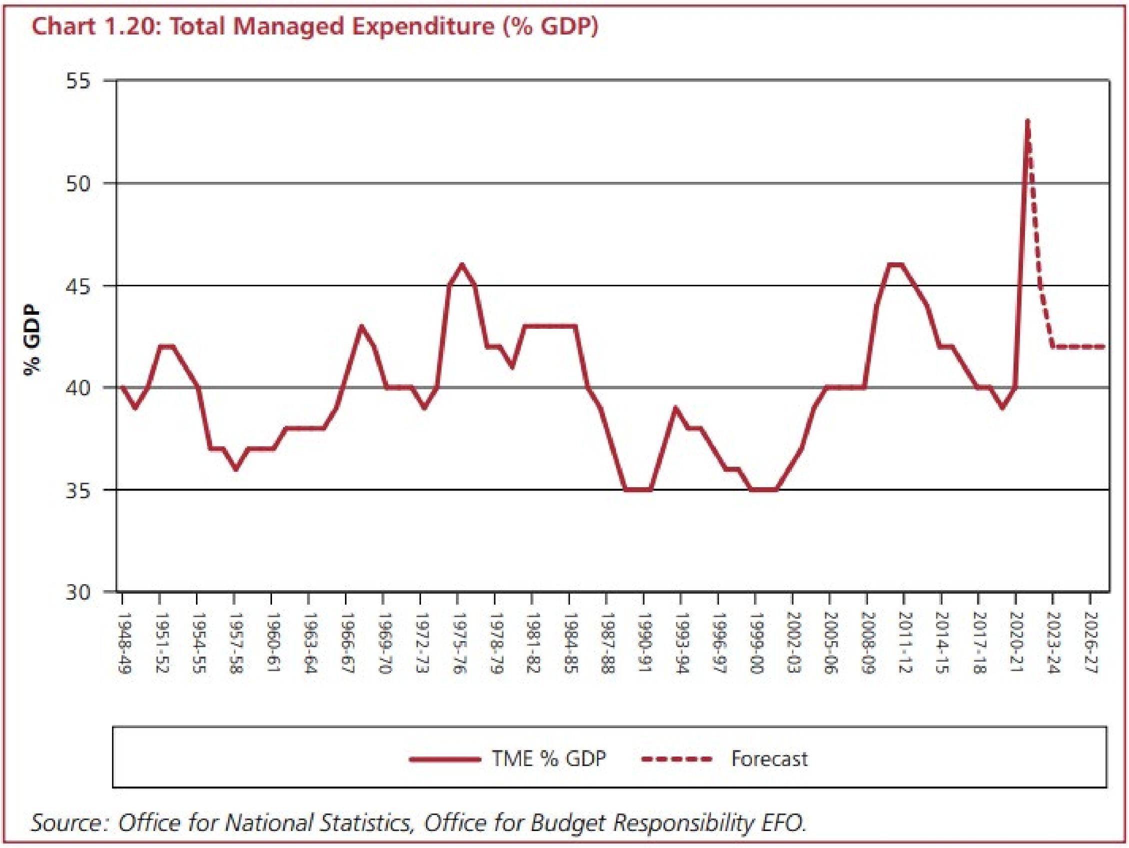
56. This Spending Review increases resource spending classified under the Departmental Expenditure Limits—often referred to DEL or day-to-day expenditure on public services—by an annual average of 3.1 per cent compared to financial year 2019–20 (the financial year prior to the COVID pandemic).[68]

57. The Spending Review increases total capital spending—spending made by departments on assets and investment—classified within DEL by an annual average of 6.7 per cent compared to 2019–20.[69]

58. As shown in Figure 6 below, if the immediate responses to the financial crisis and the pandemic are excluded, Total Managed Expenditure[70] in the 2020s is forecast to be at its highest as a proportion of GDP since the mid-1980s:

66 HM Treasury: Autumn Budget and Spending Review 2021, Table 1.18
67 HM Treasury: Autumn Budget and Spending Review 2021, Executive Summary
68 HM Treasury: Autumn Budget and Spending Review 2021, Table 1.5
69 HM Treasury: Autumn Budget and Spending Review 2021, Table 1.5
70 Total government spending classified under both Departmental Expenditure Limits (DEL) as well as Annually Managed Expenditure (AME)

Figure 6: HM Treasury chart showing forecast Total Managed Expenditure[71]



Overall tax burden

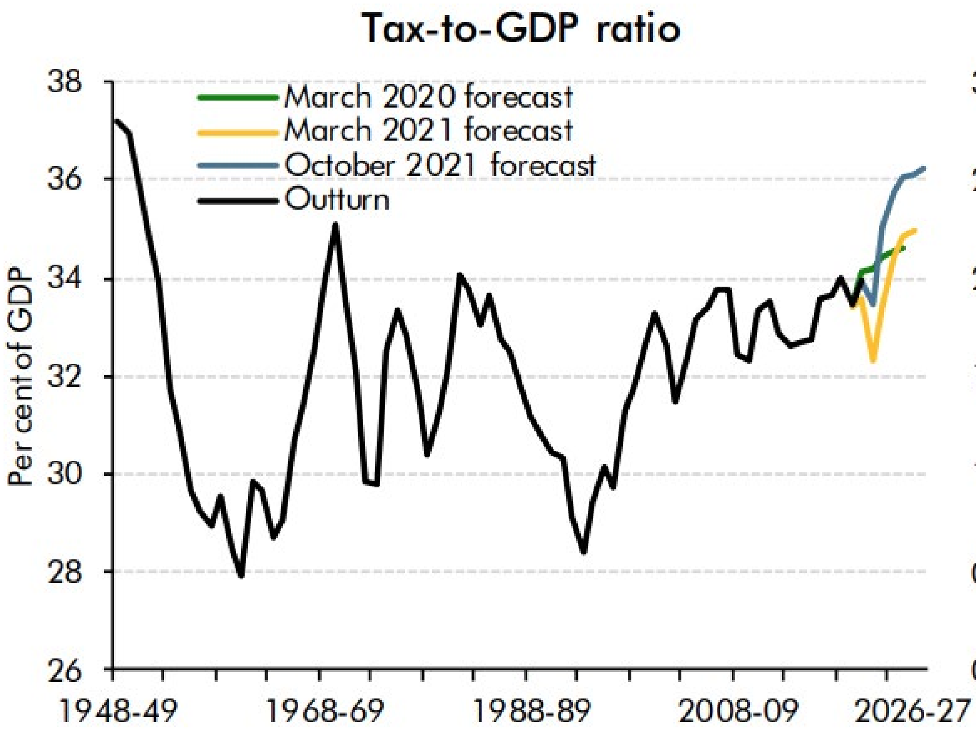
59. At the Budget in March 2021 the Chancellor raised corporation tax from 19 per cent to 25 per cent, and froze income tax thresholds for five years, raising £17 billion per year and £8 billion per year respectively by the end of the forecast period.[72] Ahead of this Budget the Government temporarily increased the rate of National Insurance by 1.25 percentage points, and will introduce a new Health and Social Care Levy from 2023–24 onwards (covered in detail in the next chapter), raising £17 billion gross per year. When put together these three policies announced within seven months will have raised an additional £42 billion per year by the end of the forecast period.

60. In its Economic and Fiscal Forecast the OBR highlighted that recent fiscal events had taken the tax burden to a historically high level:

> Stronger and more tax-rich growth, coupled with the tax rises announced over the last two Budgets, raise the tax burden from 33.5 per cent of GDP recorded before the pandemic in 2019–20 to 36.2 per cent of GDP by 2026–27–its highest level since late in Clement Attlee's post-war Labour Government in the early 1950s.[73]

71 HM Treasury: Autumn Budget and Spending Review 2021, Chart 1.20
72 HM Treasury: March Budget 2021, Table 2.1
73 OBR: Economic and Fiscal Outlook October 2021, paragraph 1.21

Figure 7: OBR October EFO 2021, Chart 1.6: Taxes as a share of GDP



61. In his Budget Speech the Chancellor stated that it was his ambition to reduce taxes in the future:

> At the March Budget, we took the difficult but necessary decision to increase the rate of Corporation Tax to 25% from 2023 … still the lowest rate in the G7 and the fifth lowest rate in the G20. Alongside, I introduced the new Super Deduction - the biggest business tax cut in modern British history. My goal is to reduce taxes. By the end of this Parliament, I want taxes to be going down not up. […] That is my mission over the remainder of this Parliament.[74]

62. When we asked the Chancellor why he had increased taxes, he told us it was primarily to pay for the consequences of the COVID pandemic. He said:

> The last thing I would do is voluntarily raise taxes. We have done that to fund what we needed to do, which is to fix the damage that coronavirus has done, to make sure that the NHS can get the resources it needs to recover from the pandemic, when the backlog was going to stretch to unacceptable levels, and to fund what are landmark reforms of the social care system, which other Governments have not done. […] It is a once-in-a-300- year economic shock. It is unsurprising that it has had some consequences.[75]

63. We were told by Torsten Bell that, due to the pandemic, the increases in the tax burden were not surprising, but that it was not all down to health spending. He said:

> The big picture, which is that taxes will be higher at the next election than they were at the last one, is pretty much baked in now. Smaller economy.

74 HC Deb, 27 October 2021, col274

75 Q165

> Spending a lot more money on health and care. […] But there is also a cross-party consensus on wanting to have a much higher amount of capital spending. This is the first recession where we won't come out of it cutting capital spending, for decades. I think it is a perfectly reasonable thing to do, but it needs your state bigger as a share of GDP and, given that you have a debt target, it also means it's contributing to the pressure on putting up taxes.[76]

64. When we asked our witnesses whether the Chancellor would be able to meet his ambition of cutting taxes before the end of the Parliament, they said that it was theoretically possible because the Chancellor had given himself some headroom, but that other spending pressures may make it unlikely. Dr Tetlow said:

> If the OBR's forecasts turn out to be exactly right, there is headroom against the deficit and debt targets, and therefore you could cut taxes. The one other pressure that might make that difficult is that although quite a lot of extra money did go into spending in this Spending Review, there are still areas where it looks like it is going to be a struggle to deliver the kind of services that the public might be expecting on the settlement that's gone in.[77] […] Social care, particularly, is the one that looks difficult. Most of that extra money [money raised from new social care levies] was really going in to help meet the new expanded offer that was announced in September. There isn't really extra money to meet the pre-existing gaps in social care provision, which were already baked into the system.[78]

65. Paul Johnson agreed, saying:

> I would be really surprised if the tax burden in 10 years' time were lower than it is now or lower than it will be after the currently pencilled in tax rises. All the pressures are in an upward direction—from health, from social care, from the population ageing and, in general, from the continued pressures after a decade of cuts in various areas. There are big choices one could make there, but I do not sense much political consensus for significant cuts in spending to pay for those pressures in health and elsewhere. If you ask me to lay a bet, it would be that we will get a headline tax cut before 2024, but by 2030 the tax burden will still be higher.[79]

66. **It was against the backdrop of the Covid pandemic that the Chancellor announced a large increase in departmental spending at this Spending Review, with real-terms increases for all departments. However, the Chancellor also declared his intention to cut taxes later in this Parliament. It already appears to be a significant challenge for the tax burden as a percentage of GDP to be lower at the end of this Parliament than at the beginning, because the Chancellor's tax rises have already been announced, and his fiscal headroom to reduce them and still meet his fiscal target is small.**

76 Q223
77 Q224
78 Q225
79 Q225

67. **It is understandable that total departmental spending is rising at present, and that the UK's tax burden will rise to levels not seen during peace time, given that the country is still in the midst of a global pandemic, which has at times shut down major sections of the economy and has placed significant demand pressure on many areas of public spending. However, not all departmental spending choices that the Chancellor made were pandemic-related. If the Chancellor wishes to be able to cut taxes later in this Parliament while still meeting his fiscal rules, he may have to identify areas of departmental spending where he can reduce spending in real terms even if this is in the face of increased demand.**

Levelling up

68. The executive summary of the Autumn Budget and Spending Review 2021 states that "Delivering on the commitment to level up all of the UK underpins the choices made in the Budget and Spending Review."[80] The Budget provides this description of what levelling up represents:

> The Government's approach to levelling up is underpinned by four principles:
>
> - spreading opportunity and improving public services, particularly where they are weaker
> - boosting living standards, particularly where they are lower
> - restoring local pride
> - empowering local leaders and communities.[81]

The Budget also stated that the Levelling Up White Paper would be published in 2021.[82] It has been delayed until the end of January.[83]

69. The 2020 Spending Review announced a £4.8 billion Levelling Up Fund.[84] In the 2021 Autumn Budget and Spending Review, the Levelling Up Fund remained at £4.8 billion, but £1.7 billion of the Fund was allocated.[85]

70. The 2021 Spending Review states that:

> Improving outcomes in education, skills and health is essential to helping people into jobs and improving their prospects. Evidence suggests that between 60% and 90% of area-level disparities in wages in the UK can be explained by differences in human capital, which encompasses these three areas. Investing in people is therefore at the centre of the government's levelling up agenda."[86]

80 HM Treasury: Autumn Budget and Spending Review 2021, Executive Summary
81 HM Treasury: Autumn Budget and Spending Review 2021, paragraph 2.121
82 HM Treasury: Autumn Budget and Spending Review 2021, Executive Summary
83 Local Government Chronicle: Levelling up white paper delayed 'until January', 6 December 2021
84 HM Treasury: Spending Review 2020, Executive Summary
85 HM Treasury: Autumn Budget and Spending Review 2021, Executive Summary
86 HM Treasury: Autumn Budget and Spending Review 2021, 2.126

In addition to the Levelling Up Fund, the Government has launched the UK Shared Prosperity Fund (UKSPF) and which is described in the Spending Review as "the centrepiece of this ambition".[87]

71. The Spending Review announced that the UKSPF would be worth £2.6 billion over the next three years,[88] approximately £0.87 billion per year. It will rise to £1.5 billion per year by 2024–25.[89] The Spending Review states that the UKSPF is the "successor to the EU Structural Fund programme and will better tailor funding to local needs across the UK". The £1.5 billion annual budget for the UKSPF (by 2024–25) is a 40 per cent reduction compared to the amount that the UK received per year from the EU Structural Fund programme during the most recent period (2014–2020), which was £15.4 billion, or on average £2.5 billion per year.[90]

72. Levelling up as a concept is mentioned 91 times within the Autumn Budget and Spending Review and is featured within the sections on education, local government, innovation, infrastructure, living standards and decarbonisation among others.

73. We asked the Chancellor what is the one outcome on which the Government is most focussed when it comes to its levelling up agenda for this Parliament. The Chancellor gave a broad answer that incorporated several areas of government spending:

> One is pride in place and making sure that people, wherever they live, feel that the community that they live in is a richer, nicer place to live in. The levelling-up fund and the community ownership fund are good examples of that type of activity. Cultural investment and sports investment in, for example, football pitches are probably in that bucket.
>
> The other thing is just about opportunity. I know that that is a broad word, but whether you are growing up in a village in the south-west or on the south coast, or up in the north-east near me, it is about feeling that there is an opportunity that has been provided for you to fulfil everything you want to do in your life. If you are in Teesside, that will be about the freeport and the transition to hydrogen and carbon capture and storage. It will be about the Treasury being there. That will make people feel that levelling up has been delivered. If you are in a village in the south-west, it might be about broadband in a rural area. It will be slightly different things, but it is this idea that, "Where I am, opportunity is too".[91]

74. We then asked the Chancellor whether it was possible that the Government's levelling up policies in this Spending Review were spread too thinly for people to notice them, to which the Chancellor said levelling up was more of a "mindset":

> It is also a mindset across Government about doing things in a way where the default is not always going to the same places that you have always done things, and just being cognisant of the fact that there are lots of different parts of the country where, by the way, we can have a Treasury office or put

87 HM Treasury: Autumn Budget and Spending Review 2021, 2.127
88 HM Treasury: Autumn Budget and Spending Review 2021, 2.127
89 HM Treasury: Autumn Budget and Spending Review 2021, 2.127
90 House of Commons Library: EU funding in the UK, Number 7847, 11 September 2020, paragraph 2.1
91 Q211

> in a freeport, for example. That mindset changed, and the changes that we made to the Green Book last year will percolate down and ensure that there is just a different way of thinking about these things going forward, which will be beneficial.[92]

75. We asked Dr Tetlow what her views were on whether the Government had prioritised its Levelling Up agenda, and she told us that the Department for Levelling Up, Housing and Communities had not seen a very generous Spending Review settlement, despite it being the department through which most levelling up concepts would be delivered:

> The other loser was local government: spending power there is going up more than it has in recent spending reviews, but once you strip out the money already ring-fenced for the increased generosity of the offer on social care, it still looks like they will have to cut services on non-children and adult social care to try to make enough money available to deal with existing pressures that were already there.[93] […] The trajectory we have seen in the last decade, when local government has had repeated tight spending settlements, is that more and more of the budgets have just focused on the statutory duties of local authorities, which are principally adult social care and children's social care. If there continues to be pressure for more spending on those areas, that means you need to find savings from everything else. […] It is striking that some of those other things that local authorities do are the sorts of things that the Government have talked about as being important civic capital for local areas as part of levelling up. That means things like youth centres, parks and roads, and all those sorts of things are within the rest of the local authority budget that has been squeezed over the last decade.[94]

76. Torsten Bell agreed, saying that the Government is giving out small amounts of capital funds to improve local areas, but will not commit to funding local authorities to maintain such improvements in the longer term:

> [The Government] is holding down local government spending, broadly continuing the pattern to a much less significant degree than we saw in the last decade, but wanting some of the things that local government traditionally provided to improve, which is the feel of the place—the town centre, the high street—and doing that with targeted capital spending, which we tend to be delivering via funds that local authorities bid into to provide those increases. […] Local government does not have the current or capital spending to maintain that. We want to dole out the cash as capital, but we do not want to give control and revenue spending to local authorities.[95]

77. **The Spending Review described how levelling up was being incorporated into many aspects of government policy. We await more specific detail on how levelling up will be measured and achieved. Rebadging existing programmes may not have the impact the Government is seeking.**

92 Q212
93 Q288
94 Q299
95 Q299

78. **The Government stated that the UK Shared Prosperity Fund will be the successor to the EU Structural Investment Funds. However, the Government is only providing to this new fund 60 per cent of the money provided by the EU fund. If the new fund is intended to be one of "the centrepieces" of the Government's ambition, it is surprising that the size of the fund is being reduced to such an extent. The Government will need to demonstrate how these reduced funds will achieve their defined metrics for levelling up.**

79. **Significant elements of the Government's levelling up agenda will be delivered through the Department for Levelling Up, Housing and Communities (DLUHC). However, once the increases in social care funding are excluded, the spending power for this department's activities are being kept flat or falling. If the levelling up agenda is to be carried out in a sustainable way, it may be that this will need to be reflected in the spending power of the DLUHC. This Committee awaits this Department's forthcoming White Paper to understand how levelling up will be measured and achieved within the budgets announced.**

80. We will be looking at levelling up in more detail in our Equal Recovery inquiry.[96]

96 Treasury Committee: An Equal Recovery, accessed 19 January 2022

3 Individual Budget measures

Social care

New taxes

81. On 7 September 2021, the Prime Minister announced plans to increase substantially funding for health and social care over the next three years (2022- 2025), to be funded by a new hypothecated tax, the Health and Social Care Levy. The new changes to the social care system will only apply in England. Health and social care is a devolved policy in Scotland, Wales, and Northern Ireland. However, the changes in taxation will apply to all four countries within the United Kingdom. The Government has stated that the increase in money raised will be allocated to Scotland, Wales, and Northern Ireland in line with the Barnett formula.[97]

82. The Prime Minister announced:

- A temporary 1.25 percentage point increase to the rate of National Insurance for classes 1 (employees), 1A (employers) and 4 (self-employed)[98] for the 2022–23 tax year.
- From 2023–24 this temporary rise in National Insurance will be replaced by a new 1.25 per cent tax on the same tax base as National Insurance, to be called the Health and Social Care Levy.
  - From 2023–24 this will also apply on the wages of individuals who are above the State Pension age, who until now have not had to pay National Insurance.[99]
- A 1.25 percentage point increase on the rate of dividend tax.[100]

83. The OBR forecast that the introduction of the Levy would raise approximately £12.5 billion per year in net additional government spending capability. The gross amount which the measure would raise is forecast to be approximately £17 billion per year, but this yield would be reduced, firstly by lower wage settlements for workers from their employers in future, and secondly through the additional money the Treasury has decided to provide to government departments in order to pay the new Levy on their own payrolls.[101]

84. The OBR forecast that the dividend tax increase would raise approximately £900 million per year by the end of the forecast period.[102]

85. By increasing the level of taxation through National Insurance, the incidence of the Levy will be on those whose income comes from wages, and on companies who employ workers. Had the Government chosen to raise the tax through income tax instead, it would have expanded the tax base to include income that individuals derive from other sources

97 HM Government: Build Back Better, Our plan for health and social care, paragraph 87
98 HM Government: Build Back Better, Our plan for health and social care, Table 1
99 HM Government: Build Back Better, Our plan for health and social care, Table 60
100 HM Government: Build Back Better, Our plan for health and social care, paragraph 9
101 OBR: Economic and Fiscal Outlook October 2021, Table A.2
102 OBR: Economic and Fiscal Outlook October 2021, Table A.2

such as rental income, or pension income, as well as income from wages. When the Prime Minister announced the plans, he said that the reason why the Government had chosen National Insurance over income tax to raise the money was to make employers—as well as individuals—contribute to the money raised. He said:

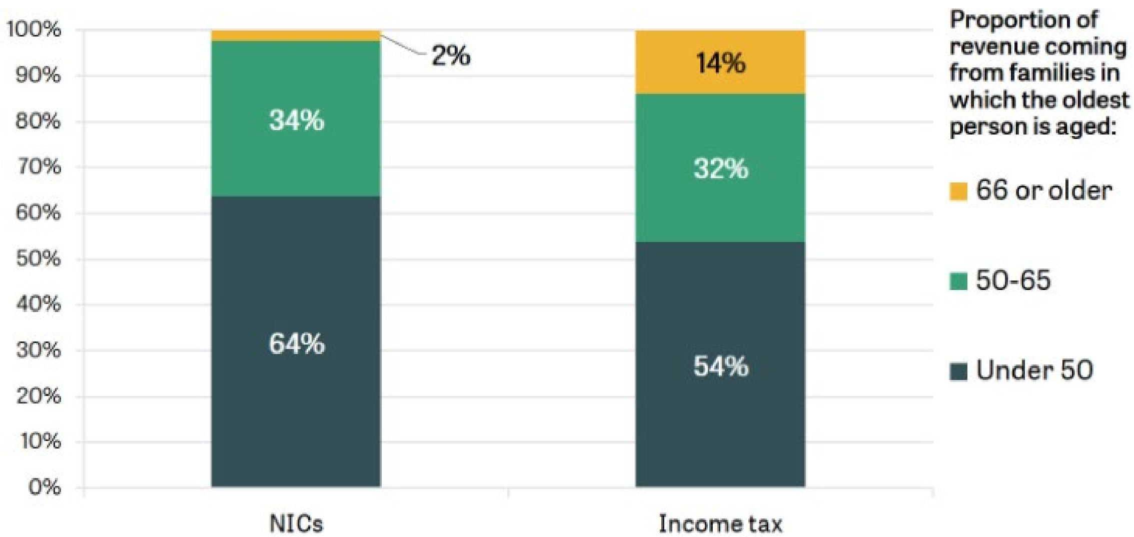
> Income tax is not paid by businesses, so the whole burden would fall on individuals, roughly doubling the amount that a basic rate taxpayer could expect to pay […] our new levy will share the cost between individuals and businesses, and everyone will contribute according to their means, including those above state pension age.[103]

86. In response to the Government's announcement of the new Levy, Paul Johnson wrote that it would affect workers far more than pensioners, and that it would add complexity to the tax system:

> A levy of 1.25% on employee earnings and on employer wage costs (so a 2.5% overall increase in the tax rate on earnings), will raise £14 billion a year. The extension of this levy to those over state pension age and to dividends is welcome, but this remains a tax which will be overwhelmingly borne by workers with very little coming from pensioners. This continues a trend seen over many decades of the burden of tax being shifted towards earnings. The creation of an entirely new tax will mean yet more quite unnecessary complexity. […] It is disappointing that the government did not find a better package of tax measures to fund these spending increases. A simple increase in income tax would have been preferable.[104]

87. Figure 8 shows the IFS's estimation of how much each age cohort would contribute, should the money be raised via income tax, compared to National Insurance:

Figure 8 Institute for Fiscal Studies chart showing: Contribution of different age groups to the revenue raised by increasing the basic and higher rate of income tax or all rates of NICs[105]



103 HC Deb, 7 September 2021, col153

104 Institute for Fiscal Studies: An initial response to the Prime Minister's announcement on health, social care and National Insurance, 7 September 2021

105 Institute for Fiscal Studies: Pensioner families would provide ten times more of the revenue from an income tax rise than from a NICs rise, 6 September 2021

New thresholds

88. Together with announcing the increases in taxes to raise additional money for adult social care, the Prime Minister announced a series of measures to change how much individuals would have to contribute towards their own care. The Prime Minister announced that:

- Anyone whose assets had reduced to below £20,000 would not have to contribute any more of their own assets towards their care. Prior to the announcement this threshold—as implemented—stood at £14,250.
- The asset thresholds above which someone would not be entitled to means tested support towards their social care were increased from between £14,250 and £23,250 to £20,000 and £100,000.
- An individual lifetime cap on an individual's contribution towards their social care costs of £86,000 was to be introduced. Prior to the announcement—as implemented—there was no cap.
- The increased means testing thresholds would be expanded to people receiving care in their home, who previously were not entitled to means testing.[106]

89. After the Budget on 17 November the Government further announced through a Written Ministerial Statement that "only the amount that the individual contributes towards these costs will count towards the cap on care costs".[107] The means tested contribution made by an individual's local authority towards an individual's care would therefore not count towards their lifetime contribution cap.

90. In assessing these reforms, there are two baselines against which they should be compared. The first baseline is in effect a set of baselines—those used in the paragraph above, which are what the current thresholds are in practice. The second baseline is the package for reform of the social care policy framework that had been legislated for in the Care Act 2014 but which have not been implemented, often referred to as the "Dilnot proposals".

91. The Dilnot Commission was set up in July 2010 by the Coalition Government, tasked with making recommendations for changes to the funding of care and support in England. The Care and Support Commission, chaired by Sir Andrew Dilnot, published its report in July 2011 (known as the "Dilnot report").

92. The Dilnot Report recommended:

- A lifetime cap on individual contributions of between £25,000 and £50,000, and chose £35,000 as its illustration.[108]
- An upper cap of £100,000 for means testing and a lower cap of £14,250.[109]

106 Q308
107 HC Deb, 17 November 2021, 399WS
108 The Report of the Commission on Funding of Care and Support, July 2011, page 22
109 The Report of the Commission on Funding of Care and Support, July 2011, page 35

- The means tested contribution made by an individual's local authority towards an individual's care would count towards their lifetime contribution cap.[110]
- A series of tiered lower lifetime caps for people who had care needs while of a working age.[111]
- People receiving care in their own home would not receive the same level of means tested support as someone receiving residential care.[112]

93. Following the Commission's report, the Coalition Government published a White Paper and the draft Care and Support Bill, before introducing the Care Bill to Parliament–which was placed on the statute book to become the Care Act 2014. Much of the Dilnot Report's recommendations were placed into law, but they were never enabled, and were therefore never implemented.[113]

94. In mid-July 2015, some two and a half months after the General Election, the new Conservative Government announced a four-year delay in the introduction of the lifetime cap on social care costs.[114] There had been no changes since the announcements made in the Autumn of 2021.

95. Alongside the Prime Minister's announcement in September 2021, the Government provided analysis which stated that "Nobody is worse off under the 2021 reform proposals compared to the current system, and many are better off".[115] By "the current system", the Government was referring to the system which was in place, not that which had been legislated for following the Dilnot review. The Government's analysis estimated that as an example, of the 360,000 recipients of long-term care who are over the age of 65, 30,000 would benefit from the new means test thresholds, and a further 60,000 would benefit from the cap on costs and the means test.[116]

96. Sir Andrew Dilnot told us that two elements of the Government's new proposals were more generous than his proposals. Firstly, under his proposals, the increase in the means tested asset thresholds up to £100,000 would only be applied to individuals who received residential care, whereas the Government had included both residential and domiciliary care within its means tested framework.[117]

97. Secondly, the Government's cap on residential living costs was more generous than Dilnot's. Living costs which include the food and the deemed cost of the accommodation within a care home itself are not included within an individual's lifetime £86,000 cap. Therefore, the higher the deemed living costs of a care home, the more an individual will have to pay towards their own care. Sir Andrew told us:

110 The Report of the Commission on Funding of Care and Support, July 2011, page
111 The Report of the Commission on Funding of Care and Support, July 2011, page 24
112 The Report of the Commission on Funding of Care and Support, July 2011, page 28
113 *Reform of adult social care funding: developments since July 2019 (England)*, Briefing Paper Number 8001, House of Commons Library, 14 May 2020
114 *Reform of adult social care funding: developments since July 2019 (England)*, Briefing Paper Number 8001, House of Commons Library, 14 May 2020
115 HM Government: Adult social care charging reform: analysis, 3 December 2021
116 HM Government: Adult social care charging reform: analysis, 3 December 2021
117 Q308

> The level that the Government are proposing now, at £200 a week, is, in real terms, probably about £30 a week more generous to individuals than what was proposed in 2015.[118]

98. Sir Andrew then explained to us the ways in which the Government's proposals were less generous than what he had proposed. They were that:

- The £86,000 lifetime cap is less generous than his proposed £35,000.[119]
- The £100,000 upper asset threshold for means testing, while the same amount in nominal terms as his proposal, is less generous in real terms given there has been ten years of inflation since he proposed the figure.[120]
- The means tested contribution that individuals receive from their local authority will not count towards the individual's lifetime contribution cap, whereas under his proposals it would.[121]

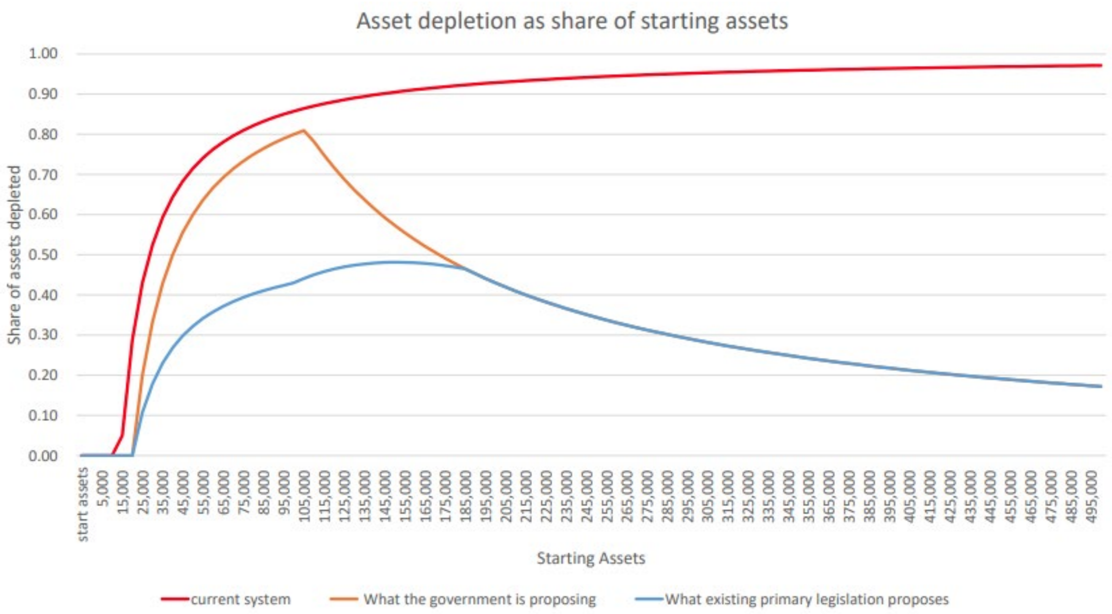
99. Sir Andrew drew our attention to the means tested contribution as being the divergence from his proposals that mattered the most, and he said he was "very disappointed"[122] about it. He told us that by not including the contributions of the local authority against an individual's lifetime cap, the benefits of introducing such a cap were significantly diminished. He said:

> For those who have long care journeys or significant care needs, the less well-off will not gain any benefit from the cap. […] The people who are most harshly affected by this change will be those with assets of exactly £106,000—that is the £86,000 of cap plus £20,000 that is protected by the means-tested system. Everybody with assets of less than £186,000 would do less well under what the Government are proposing than the proposals that we made structurally and those that are legislated for. That is a big change that was announced yesterday, and it is disappointing. It finds savings exclusively from the less well-off group.[123]

100. In evidence to us he presented the following chart (figure 9) which modelled the maximum proportion of an individual's assets they might deplete if they required many years' of social care under the existing framework (red line), the Dilnot framework (blue line) and the Government's new proposals (orange line):

118 Q308
119 Q308
120 Q308
121 Q310
122 Q310
123 Q310

Figure 9: Sir Andrew Dilnot's chart showing maximum asset depletion an individual would face based on their initial level of assets prior to requiring care[124]



101. As can be seen, under the existing system, there was no limit to an individual's contribution to their care, so the proportion of assets one can use up has no upper limit: an individual would only stop using up their resources once they had reached their final £14,250. Between £20,000 and £186,000 under the Dilnot proposal, an individual would use up less of their resources than compared to the Government's new proposals, because more of an individual's lifetime allowance would be paid for by their local authority. Above £106,000 the line representing the Government's proposal begins to fall because an individual will have hit their £86,000 lifetime allowance cap. For those with more than £186,000 in assets, there is no difference in outcome between the Dilnot proposal and the new government proposal because the individual will have reached their individual lifetime cap before they qualify for means tested support.

102. The Government produced its own charts with similar analysis to Dilnot's, but it stated that Sir Andrew's chart "focused on what the maximum level of asset depletion that somebody could theoretically face if they received care for an infinitely long period of time".[125] Instead, the Government's analysis focused on what the asset depletion would be for an average length of stay in residential care of 97 weeks, or if a stay were to last 10 years. Under the Government's analysis, if an individual stayed in care for 97 weeks, the level at which they had depleted their assets would be much the same under either set of proposals. However, if they stayed in care for 10 years, they would be better off under the new proposals if they had assets of more than approximately £140,000 whereas if they had fewer than £140,000 in assets they would be better off under Dilnot's proposals.[126]

124 Sir Andrew Dilnot written evidence. (AUB0005)
125 Letter from Secretary of State for Health and Social Care to Treasury Committee Chair, 22 November 2021
126 HM Government: Adult social care charging reform: analysis, 5 January 2022

103. The profile of someone who will be worse off (as described by Sir Andrew) is someone who experiences a long care journey and therefore incurs care costs over a longer period of time. Sally Warren, Director of Policy at the King's Fund, told us that "on average, most people starting their care journey will not be spending that level."[127] Her organisation estimates around one in seven people will face individual costs of over £100,000.[128]

104. Sir Andrew also told us that it is not just those who end up using the care system who would benefit from lifetime costs being lower. He told us that people benefit from the peace of mind knowing that in later life, should they need care or not, their home and their assets are not at risk from having to be sold in order to pay for care. He used house insurance as an analogy:

> When we think of the benefit of having our houses insured, we do not think that the people who benefit from home insurance are those whose houses burn down. We think that it is all of us, as we leave our flat or house in the morning, knowing that, in the very unlikely event that it burns down, we are not facing catastrophe. That is the critical thing.[129]

105. **Compared to the existing adult social care framework in England of thresholds and the absence of any lifetime spending caps, the Government's new policy proposals are more generous. All individuals will now have a lifetime cap on contributions where previously there was none. In addition, many more individuals will now be eligible for means tested support. These changes are welcome.**

106. **Compared to the Dilnot proposals the Government's measures are more generous with regard to those who receive care in their own home. In addition, the cap on how much a care home can charge for weekly "living costs" has been capped in real terms at a higher amount than under the Dilnot Review.**

107. **However, when compared to the Dilnot Review's recommendations that had been legislated for but which have not yet been commenced, the Government's proposals are less generous in how they treat the means tested contribution made by local authorities. As a result, while most people will pay less as a result of the proposals overall, those who have a longer care journey and have assets of between £20,000 and £106,000 will pay far more towards their own care than they would have done under the provisions of the Care Act 2014. Even if people within this cohort do not as individuals end up needing care, they are still exposed to far greater financial risk of having to contribute £86,000 of their own money in full than would have been the case under the provisions of the Care Act 2014. It is regrettable that a such a large cohort of people are still exposed to the possibility of incurring these high costs, which make up a large proportion of their assets. Compared to the original Dilnot proposals, this will be regressive.**

108. The Government's recent proposals for the treatment of the means tested contribution by local authorities form part of the Health and Care Bill currently before Parliament. It remains to be seen whether the Bill will be amended in some way so as to mitigate the impact of these provisions upon affected groups.

127 Q362
128 Q362
129 Q355

Universal Credit taper rate

109. The Government announced within the Autumn Budget 2021 that the taper rate applied to Universal Credit (UC) payments would be reduced from 63 per cent to 55 per cent.[130]

110. The UC earnings taper rate dictates how much an individual's UC is reduced by when their income increases. At a taper rate of 55 per cent, for every £1 an individual earns above their work allowance (if they are eligible for one) their UC will be reduced by 55p.[131]

111. Torsten Bell told the Committee that the reduction in the UC taper rate was a substantial increase in the generosity of UC:

> The universal credit change is a big one […] £3 billion extra going to working universal credit claimants is a big change in direction from the last 10 years. […] It has a big impact on people's actual living standards. Over 2 million households will get £1,000 more on average, just looking at this change specifically. […] there is a big improvement in work incentives for large chunks of those households. It is a really good thing.[132]

112. However, when the reduction in the taper rate is considered together with the termination of the temporary £20 weekly uplift in UC that had been introduced in response to the pandemic that came to an end in October, Torsten Bell said large groups of people would not be better off:

> The poorest in the universal credit system and those who are not working are getting absolutely hammered. […] Lower earners who are on universal credit, have lost the £20 and will gain something from the taper changes will generally be losers.[133]

113. **We welcome the reduction in the Universal Credit taper rate. It will provide a stronger incentive for many to take on additional work. The additional money will be welcome for many households. However, the taper rate reduction will be of no benefit for recipients of Universal Credit who are not able to work. The Government should think carefully about how it intends to support such people, given the increases in the cost of living that are emerging.**

130 HM Treasury: Autumn Budget and Spending Review 2021, paragraph 2.94
131 DWP: Universal Credit work allowances, 24 November 2021
132 Q266
133 Q266

4 Budget process

Social care announcements and legislative changes

114. As noted above, on 7 September 2021 the Prime Minister announced to the House major changes to the way that adult social care is funded, and how individuals will fund their own care. These included increases in the rate of National Insurance, increases in the dividend tax rate and the creation of an entirely new tax, the Health and Social Care Levy. Paul Johnson, referred to the announcement as "a Budget in all but name".[134]

115. Seven weeks later, on 27 October, the Government published a Budget, which contained no significant changes to the social care measures announced in September. Three weeks later, on 17 November, Gillian Keegan (Minister of State for Health) issued a Written Ministerial Statement announcing changes to the treatment of the means tested contribution by local authorities, for the purposes of calculating an individual's liability. The changes were brought forward as a Government amendment to the Health and Care Bill, which was at the time awaiting report stage in the Commons.

116. The House was asked to vote on the principle of the measures within the Prime Minister's announcement on 8 September, just one day after they had been announced. The House was therefore asked to vote on the measures without any forecast from the OBR, the independent official forecaster, of how much they would cost. Instead, the House had to rely on forecasts prepared by the Treasury. When the updated measures on means testing were announced, the House was asked to vote on the Government amendment to the Health and Care Bill on 22 November, five days after it had been tabled.

117. On 19 November the Government published two charts setting out two specific examples of how the changes announced to means testing would affect an individual. The first chart set out the proportion of assets that would be depleted by an individual having been in the care system for 10 years, the second chart set out the same analysis but for an individual having been in the care system for 97 weeks.[135]

118. On 18 November, the day after the announcement had been made, the Chair of this Committee wrote to the Government asking for distributional and costings analyses by household and individual income and wealth, and for information on the impact by region.[136]

119. The Secretary of State for Health's reply was sent to us at 9.34pm on 22 November, less than 30 minutes before the vote on the relevant amendment was held. In that letter the Secretary of State wrote that the information requested was not yet available:

> The full Impact Assessment for our proposals will be published early in the new year. We are unable to provide information at a regional or individual level, as the funding at local authority level has not yet been agreed.[137]

134 Institute for Fiscal Studies: An initial response to the Prime Minister's announcement on health, social care and National Insurance, 7 September 2021

135 HM Government: Adult social care charging reform: analysis, 19 November 2019

136 Letter from Rt Hon. Mel Stride MP, Chair of Treasury Committee to Chancellor of the Exchequer regarding social care funding, 18 November 2021

137 Letter from Secretary of State for Health and Social Care to Rt Hon. Mel Stride MP Chair of Treasury Committee regarding social care funding, 22 November 2021

120. **The Government should wherever possible announce major changes to the rates of existing taxes and the introduction of new taxes at a Budget or other fiscal event such as a Spring Statement. This allows Parliament to consider the measures announced alongside an independent forecast by the OBR of the fiscal consequences of the measures.**

121. **For both social care announcements, the House was asked to vote on new government policies that came with significant distributional impacts for households, without the usual distributional analysis that would be provided alongside a Budget. That was highly unsatisfactory. For major announcements such as this the Government should always provide Parliament, in good time, with the information required to enable Parliament to make an informed decision. The Government's social care plans had been under development for a number of years, and it is not clear why the necessary distributional analyses, both by region and by household, were not provided at the time the House was asked to vote. Nor is it clear why the announcements on social care were made in two distinct stages.**

Budget measures pre-briefing

122. In March 2013, a significant number of Budget policies leaked to the Evening Standard prior to the Chancellor's Budget Statement to the House. As a result, the then Chancellor (the Rt Hon. George Osborne MP) asked Nick (now Lord) Macpherson, the then Permanent Secretary of the Treasury, to "conduct a review into the practice of the proactive pre-releasing of budget information under embargo on Budget day".[138] In his review Nick Macpherson found that:

> It would be possible to set a formal limit on which information could and could not be pre-released. The most obvious information to protect in this regard would be that which is market sensitive. Introducing any element of this sort, however, risks making the pre-release discussions more partial and providing a less balanced view of the overall Budget position.[139] […] In my view, the benefits of pre-release are likely to diminish the more tightly it is controlled. This suggests to me that a ban on the release of the core of the Budget is the best way forward.[140]

123. Mr Macpherson therefore concluded that the Treasury should introduce "a ban on the pre-release of the core of the Budget (and Autumn Statement), that is: the economic and fiscal projections, the fiscal judgement and individual tax rates, reliefs and allowances".[141] These are now referred to as the Macpherson principles.

124. In the days leading up to the 2021 Autumn Budget, journalists tweeted that they had received six embargoed press releases from the Treasury on the Budget.[142] On 26 October, the day before the Budget, the Speaker granted an Urgent Question on "Budget: Pre-announcement of Provisions". The Speaker made a statement[143] at the beginning of the

138 HM Treasury: Review into the pre-release of Budget information, July 2013
139 HM Treasury: Review into the pre-release of Budget information, July 2013, paragraph 4.8
140 HM Treasury: Review into the pre-release of Budget information, July 2013, paragraph 4.11
141 HM Treasury: Review into the pre-release of Budget information, July 2013, paragraph 5.3
142 Twitter: @MichaelLCrick, 11.47pm 22 October 2021, @BBCJLandale, 9.35am 25 October 2021
143 HC Deb, 26 October 2021, col139

Urgent Question in which he quoted the Ministerial Code which states: "When Parliament is in session, the most important announcements of Government policy should be made in the first instance, in Parliament."[144]

125. In his answer to the Urgent Question, the Chief Secretary to the Treasury, the Rt Hon Simon Clarke MP, listed the Budget measures that had been pre-briefed to the press. However, before he did so, he told the House that all "market sensitive" details within the Budget would be "delivered by the Chancellor himself at this Dispatch Box tomorrow".[145] He set out the list of measures that had been pre-disclosed as follows (our emphasis):

> I now turn briefly to just a few of the measures we have announced: *an increase in the national living wage from £8.91 to £9.50 an hour, meaning an extra £1,000 a year for a full-time worker*; £3 billion-worth of investment to build a high-wage, high-skill economy, with a doubling of investment in 16 to 19-year-olds and a quadrupling of the number of skills boot camps; and a multibillion-pound overhaul of local transport to help level up communities across England, with transport settlements for city regions increased to £5.7 billion and allocated directly to cities. As part of the spending review, there is a £5.9 billion deal for the NHS to tackle the backlog of non-emergency procedures and to modernise digital technology, with at least 100 community diagnostic centres to help clear most test backlogs by the end of this Parliament.[146]

126. During an oral evidence session on our inquiry into the work of the Treasury, Sir Tom Scholar, Permanent Secretary at the Treasury, agreed with the assertion of the Chief Secretary that no market sensitive policies had been pre-briefed to the media and that the Macpherson principles had been upheld.[147]

127. The Financial Conduct Authority's best practice note on identifying, controlling and disclosing inside information, intended "for government departments, industry regulators and public bodies to help them in complying with the relevant obligations under MAR", states that the Market Abuse Regulations which came into force in 2016, and which the FCA is responsible for enforcing, define "inside information" as information of a precise nature which:

(1) has not been made public

(2) directly or indirectly relates to one or more issuers, or to one or more financial instruments and

(3) if it were made public, would be likely to have a significant effect on the prices of those financial instruments, or on the price of related derivative financial instruments.[148]

144 Cabinet Office: Ministerial Code, August 2019, paragraph 9.1; HC Deb, 26 October 2021, col139
145 HC Deb, 26 October 2021, col140
146 HC Deb, 26 October 2021, col140
147 Treasury Committee Oral evidence: The work of the Treasury, HC 912, Q37
148 FCA: Best practice note - Identifying, controlling and disclosing inside information, 9 June 2020

128. The FCA guidance also gives an example of information that may be market sensitive:

> Policy changes and consultations or conclusions of any sectoral reviews which could affect one or more companies or a sector.[149]

129. On the day that the increases in the National Living Wage were pre-briefed, The Times reported that Tim Martin, the Chairman of JD Wetherspoon PLC (a listed chain of pubs), had said the pub industry would have to increase prices by more than supermarkets, where wages are a smaller share of costs. He said that pubs and restaurants, which have to pay VAT on food sales and face higher business rates than supermarkets, would be at an even greater disadvantage. He said: "If tax equality was instigated, creating a level playing field, the pub industry would support the minimum wage increase. The tax disparity, invisible to customers, is the hidden weight on pubs and restaurants, making them, in the long term, uncompetitive."[150]

130. Sir Tom Scholar told us that "the National Living Wage is an economy-wide measure. It is not a sectoral or company-specific measure", and that it was therefore not deemed to be market sensitive.[151]

131. The Office for National Statistics classifies as market sensitive its monthly "Labour market overview" publication, which contains retrospective data on wages across the UK economy as a whole.[152]

132. The Chair of the Committee wrote to Sir Tom Scholar seeking further clarification as to why the Treasury deemed the policy to be suitable for pre-Budget briefing. In his reply to the Committee Sir Tom wrote that it was not the intention for the policy to be pre-briefed:

> In October 2021 it was decided that the Chancellor would announce changes to the NLW alongside the Budget. On the morning of 25 October, ITV News reported details of the forthcoming announcement on social media, apparently following an unauthorised disclosure of the information. […] There was clearly scope for confusion in the market as to whether the report was accurate. Recognising this, the Treasury moved as quickly as possible to regularise the situation, by bringing forward the formal on-the-record announcement.[153]

133. Sir Tom went on to write that it was his view that the information was not inside information because it was "an economy-wide measure, and not sectoral or company-specific."[154] During oral evidence Sir Tom had said to the Committee "I do not think any

149 FCA: Best practice note - Identifying, controlling and disclosing inside information, 9 June 2020
150 The Times, Budget boost for low-earners as minimum wage rises by 6.6%, 26 October 2021
151 Treasury Committee: Oral evidence session: The work of the Treasury, HC 912, 1 December 2021, Q40
152 Office for National Statistics: Changes to publication times for market-sensitive statistics, 23 March 2020
153 Letter from Sir Tom Scholar, Permanent Secretary, HM Treasury, to Chair of Committee regarding pre-Budget briefing, 21 January 2022
154 Letter from Sir Tom Scholar, Permanent Secretary, HM Treasury, to Chair of Committee regarding pre-Budget briefing, 21 January 2022

market sensitive information was improperly released".[155] However, in his letter to us, he wrote: "I did not say that the Treasury had deemed the announcement not to be market sensitive, because we had not made any such determination".[156]

134. With regard to this policy leak, Sir Tom wrote that the "The Government will review the arrangements ahead of future announcements."[157]

135. **We are deeply concerned that the rate of the National Living Wage was disclosed to ITV in an unauthorised fashion prior to the Budget, and we agree with the Treasury that this could have caused confusion in the market as to whether the information was accurate.**

136. **The rate at which the National Living Wage is set will clearly affect some companies and sectors which have large numbers of staff at the minimum wage more than it affects others who do not. Some of those firms will be listed on the stock exchange. We therefore believe that the policy may be considered to be inside information as defined by the FCA's Best Practice Note on the Market Abuse Regulations. In addition, given that the ONS deems retrospective wage data to be market sensitive, we believe it is not unreasonable to conclude that the announcement of the change to the National Living Wage rate might have been market sensitive.**

137. **The Committee acknowledges that certain Budget measures might be released prior to the Budget, in line with the Treasury's "Macpherson principles". However, under no circumstances should market sensitive policies be able to enter the public domain in a disorderly fashion.**

138. ***The Permanent Secretary to the Treasury has written to us stating the Government will review the arrangements for such policies ahead of future announcements. Given the potential opportunity for disruption that this unauthorised leak could have caused, the Government should investigate how this policy came to be leaked prior to the Budget, and should publicise its findings.***

155 Q39

156 Letter from Sir Tom Scholar, Permanent Secretary, HM Treasury, to Chair of Committee regarding pre-Budget briefing, 21 January 2022

157 Letter from Sir Tom Scholar, Permanent Secretary, HM Treasury, to Chair of Committee regarding pre-Budget briefing, 21 January 2022

Conclusions and recommendations

Economy

1. The Chancellor's fiscal rules are reasonable in the context of the pandemic and its effects. The Chancellor has set his primary fiscal rule to target the overall stock of Public Sector Net Debt, with a secondary target to run a balanced annual current spending budget. Previous fiscal mandates had primarily targeted the annual flow of spending and focussed on the stock of debt as a secondary target. We view both of the new targets as being of equal importance, and meeting one but not the other would not constitute success. (Paragraph 16)

2. According to the Office for Budget Responsibility, the Chancellor has between a 55 and 60 per cent chance of meeting his fiscal rules. He has given himself less room to meet his rules than his predecessors. The headroom may prove insufficient should one of the many risks to the economy crystallise. (Paragraph 17)

3. By setting himself rolling targets the Chancellor has given himself the flexibility to respond to any deteriorations in the forecast at future fiscal events. However, the Chancellor should not use a rolling target as a mechanism to allow himself to present a series of future Budgets that promise fiscal sustainability three years into the future, but are never fiscally sustainable in the near term. (Paragraph 18)

4. It is disappointing that the Government has pushed back its target to spend £22 billion per year on Research and Development by two years from 2024–25 to 2026–27. However, the new commitment would still represent a significant increase and bring public UK Research and Development spending above the OECD average, and above Germany, France and the US. While the target for R&D spending remains historically high, there is a risk that at future fiscal events—as was the case with this Budget—the Chancellor will again opt to make savings by delaying the increases in R&D spending. Cutting or delaying R&D spending may be a false economy, given the hopes the Government has for stimulating economic growth through its R&D spending. R&D spending is important and the Government should pursue this target with considerable determination. (Paragraph 23)

5. Due to the increase in Government debt, the proportion of gilts that are index linked, as well as the proportion of UK Government debt that has been financed through the issuance of Bank of England reserves, the public finances are highly sensitive to increases in inflation and interest rates. (Paragraph 37)

6. The OBR states that its central forecast for the path of inflation could be too low. Since the Budget, inflation has already significantly exceeded the level forecast by the OBR in October. The Bank of England raised interest rates to bring the rate of inflation back towards its two per cent target, and is likely to increase them further. It is therefore likely that by the next economic forecast, the Chancellor may be faced with significantly higher interest costs than those included within the October economic forecast. (Paragraph 38)

7. The OBR forecast states that the policy mix chosen by the Chancellor at this Budget will act as a boost to inflation, and it identified in particular the increase

in employer National Insurance Contributions, and the large fiscal loosening that took place in the Spending Review. The Prime Minister has advocated high wage growth. As the OBR has shown, there may be some fiscal benefits from inflation if the source of inflation is higher domestic wages rather than from imported and domestic inflation in the price of goods. However, setting out an economic policy of promoting high wage growth that is not accompanied by increases in productivity will be inflationary, and risks contributing to a wage price spiral. The Chancellor showed in his speech that he is alert to the fiscal risks of higher inflation and higher interest rates becoming entrenched. The Treasury should keep these risks at the forefront of their thinking when designing policies at future fiscal events. (Paragraph 39)

Spending Review and the overall tax burden

8. While some departments which had been significantly disrupted by the pandemic, such as the Department of Health and Social Care and the Department for Transport, received large increases, the Department for Education, which was also affected by the pandemic, did not receive such a generous settlement. School funding per head has only now returned to 2010 levels following the latest Budget. (Paragraph 54)

9. It was against the backdrop of the Covid pandemic that the Chancellor announced a large increase in departmental spending at this Spending Review, with real-terms increases for all departments. However, the Chancellor also declared his intention to cut taxes later in this Parliament. It already appears to be a significant challenge for the tax burden as a percentage of GDP to be lower at the end of this Parliament than at the beginning, because the Chancellor's tax rises have already been announced, and his fiscal headroom to reduce them and still meet his fiscal target is small. (Paragraph 66)

10. It is understandable that total departmental spending is rising at present, and that the UK's tax burden will rise to levels not seen during peace time, given that the country is still in the midst of a global pandemic, which has at times shut down major sections of the economy and has placed significant demand pressure on many areas of public spending. However, not all departmental spending choices that the Chancellor made were pandemic-related. If the Chancellor wishes to be able to cut taxes later in this Parliament while still meeting his fiscal rules, he may have to identify areas of departmental spending where he can reduce spending in real terms even if this is in the face of increased demand. (Paragraph 67)

11. The Spending Review described how levelling up was being incorporated into many aspects of government policy. We await more specific detail on how levelling up will be measured and achieved. Rebadging existing programmes may not have the impact the Government is seeking. (Paragraph 77)

12. The Government stated that the UK Shared Prosperity Fund will be the successor to the EU Structural Investment Funds. However, the Government is only providing to this new fund 60 per cent of the money provided by the EU fund. If the new fund is intended to be one of "the centrepieces" of the Government's ambition,

it is surprising that the size of the fund is being reduced to such an extent. The Government will need to demonstrate how these reduced funds will achieve their defined metrics for levelling up. (Paragraph 78)

13. Significant elements of the Government's levelling up agenda will be delivered through the Department for Levelling Up, Housing and Communities (DLUHC). However, once the increases in social care funding are excluded, the spending power for this department's activities are being kept flat or falling. If the levelling up agenda is to be carried out in a sustainable way, it may be that this will need to be reflected in the spending power of the DLUHC. This Committee awaits this Department's forthcoming White Paper to understand how levelling up will be measured and achieved within the budgets announced. (Paragraph 79)

Individual Budget measures

14. Compared to the existing adult social care framework in England of thresholds and the absence of any lifetime spending caps, the Government's new policy proposals are more generous. All individuals will now have a lifetime cap on contributions where previously there was none. In addition, many more individuals will now be eligible for means tested support. These changes are welcome. (Paragraph 105)

15. Compared to the Dilnot proposals the Government's measures are more generous with regard to those who receive care in their own home. In addition, the cap on how much a care home can charge for weekly "living costs" has been capped in real terms at a higher amount than under the Dilnot Review. (Paragraph 106)

16. However, when compared to the Dilnot Review's recommendations that had been legislated for but which have not yet been commenced, the Government's proposals are less generous in how they treat the means tested contribution made by local authorities. As a result, while most people will pay less as a result of the proposals overall, those who have a longer care journey and have assets of between £20,000 and £106,000 will pay far more towards their own care than they would have done under the provisions of the Care Act 2014. Even if people within this cohort do not as individuals end up needing care, they are still exposed to far greater financial risk of having to contribute £86,000 of their own money in full than would have been the case under the provisions of the Care Act 2014. It is regrettable that a such a large cohort of people are still exposed to the possibility of incurring these high costs, which make up a large proportion of their assets. Compared to the original Dilnot proposals, this will be regressive. (Paragraph 107)

17. We welcome the reduction in the Universal Credit taper rate. It will provide a stronger incentive for many to take on additional work. The additional money will be welcome for many households. However, the taper rate reduction will be of no benefit for recipients of Universal Credit who are not able to work. The Government should think carefully about how it intends to support such people, given the increases in the cost of living that are emerging. (Paragraph 113)

Budget process

18. The Government should wherever possible announce major changes to the rates of existing taxes and the introduction of new taxes at a Budget or other fiscal event such as a Spring Statement. This allows Parliament to consider the measures announced alongside an independent forecast by the OBR of the fiscal consequences of the measures. (Paragraph 120)

19. For both social care announcements, the House was asked to vote on new government policies that came with significant distributional impacts for households, without the usual distributional analysis that would be provided alongside a Budget. That was highly unsatisfactory. For major announcements such as this the Government should always provide Parliament, in good time, with the information required to enable Parliament to make an informed decision. The Government's social care plans had been under development for a number of years, and it is not clear why the necessary distributional analyses, both by region and by household, were not provided at the time the House was asked to vote. Nor is it clear why the announcements on social care were made in two distinct stages. (Paragraph 121)

20. We are deeply concerned that the rate of the National Living Wage was disclosed to ITV in an unauthorised fashion prior to the Budget, and we agree with the Treasury that this could have caused confusion in the market as to whether the information was accurate. (Paragraph 135)

21. The rate at which the National Living Wage is set will clearly affect some companies and sectors which have large numbers of staff at the minimum wage more than it affects others who do not. Some of those firms will be listed on the stock exchange. We therefore believe that the policy may be considered to be inside information as defined by the FCA's Best Practice Note on the Market Abuse Regulations. In addition, given that the ONS deems retrospective wage data to be market sensitive, we believe it is not unreasonable to conclude that the announcement of the change to the National Living Wage rate might have been market sensitive. (Paragraph 136)

22. The Committee acknowledges that certain Budget measures might be released prior to the Budget, in line with the Treasury's "Macpherson principles". However, under no circumstances should market sensitive policies be able to enter the public domain in a disorderly fashion. (Paragraph 137)

23. *The Permanent Secretary to the Treasury has written to us stating the Government will review the arrangements for such policies ahead of future announcements. Given the potential opportunity for disruption that this unauthorised leak could have caused, the Government should investigate how this policy came to be leaked prior to the Budget, and should publicise its findings.* (Paragraph 138)

Formal minutes

Monday 24 January 2022

Members present:

Mel Stride, in the Chair

Rushanara Ali

Anthony Browne

Dame Angela Eagle

Kevin Hollinrake

Julie Marson

Alison Thewliss

Draft Report (*Autumn Budget and Spending Review 2021*) proposed by the Chair, brought up and read.

Ordered, That the Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 138 read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Tenth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Adjournment

[Adjourned until Wednesday 26 January 2022 at 2.00 pm

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee's website.

Monday 1 November 2021

Richard Hughes, Chairman, Office for Budget Responsibility; **Professor Sir Charlie Bean**, Member of Budget Responsibility Committee, Office for Budget Responsibility; **Andy King**, Member of Budget Responsibility Committee, Office for Budget Responsibility Q1–93

Rt Hon Rishi Sunak MP, Chancellor of the Exchequer, HM Treasury; **Dan York-Smith**, Director of Strategy, Planning and Budget, HM Treasury; **Conrad Smewing**, Director of Public Spending, HM Treasury Q94–215

Monday 8 November 2021

Paul Johnson CBE, Director, Institute for Fiscal Studies (IFS); **Dr Gemma Tetlow**, Chief Economist, Institute for Government; **Torsten Bell**, Chief Executive, Resolution Foundation; **Nina Skero**, Chief Executive, Centre for Economics and Business Research Q216–305

Thursday 18 November 2021

Sally Warren, Director of Policy, The King's Fund; **Sir Andrew Dilnot CBE**, Warden, Nuffield College, University of Oxford Q306–387

Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

AUB numbers are generated by the evidence processing system and so may not be complete.

1 AAT (Association of Accounting Technicians) (AUB0001)

2 Sir Andrew Dilnot CBE (Warden, Nuffield College, University of Oxford) (AUB0005)

3 Chartered Institute of Taxation (CIOT) (AUB0002)

4 Institute of Chartered Accountants in England & Wales (ICAEW) Tax Faculty (AUB0003)

5 Institute of Chartered Accountants in Scotland (AUB0004)

List of Reports from the Committee during the current Parliamentary Session

All publications from the Committee are available on the publications page of the Committee's website.

Session 2021–22

Number	Title	Reference
1st	Tax after coronavirus: the Government's response	HC 144
2nd	The appointment of Tanya Castell to the Prudential Regulation Committee	HC 308
3rd	The appointment of Carolyn Wilkins to the Financial Policy Committee	HC 307
4th	The Financial Conduct Authority's Regulation of London Capital & Finance plc	HC 149
5th	The Future Framework for Regulation of Financial Services	HC 147
6th	Lessons from Greensill Capital	HC 151
7th	Appointment of Sarah Breeden to the Financial Policy Committee	HC 571
8th	The appointment of Dr Catherine L. Mann to the Monetary Policy Committee	HC 572
9th	The appointment of Professor David Miles to the Budget Responsibility Committee of the Office for Budget Responsibility	HC 966
1st Special	Net Zero and the Future of Green Finance: Responses to the Committee's Thirteenth Report of Session 2019–21	HC 576
2nd Special	The Financial Conduct Authority's Regulation of London Capital & Finance plc: responses to the Committee's Fourth Report of Session 2021–22	HC 700
3rd Special	Tax after coronavirus: response to the Committee's First Report of Session 2021–22	HC 701
4th Special	The Future Framework for Regulation of Financial Services: Responses to the Committee's Fifth Report	HC 709
5th Special	Lessons from Greensill Capital: Responses to the Committee's Sixth Report of Session 2021–22	HC 723