

The Fiscal Context

By Tom Clougherty

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Summary

- **Fiscal crisis.** The Chancellor faces a significant ‘fiscal black hole’ of around £30 billion by 2029–30. She will have to raise taxes or cut spending – or some combination of the two – if she is going to stick to the fiscal rules.
- **Spending is the problem.** Britain’s long-term fiscal imbalances are driven by spending growth that has outstripped both demographic demand and economic expansion. The state has grown from approximately 35% of GDP in the late 1990s to 45% today.
- **Taxing the rich will not work.** Increasing income tax on the highest earners would not generate the necessary sums. Significant hikes to capital gains tax would be an act of economic self-harm.
- **Spending restraint is plausible.** The fiscal rules could be met through spending restraint. Keeping overall spending increases in line with inflation until 2029–30 could improve the fiscal outlook by £40bn relative to current plans.
- **The spending challenge.** However, if cuts are focused on departmental spending, and NHS funding continues to grow in line with recent trends, cuts of 14% to non-NHS departmental spending would be required by 2029–30 – a significant undertaking.
- **Major reform is necessary.** If we are going to ensure long-term fiscal sustainability as our population ages, we need significant reform of public services, the welfare state and the tax system. This is an agenda for an entire Parliament, not a single budget.

About the author

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Introduction

On November 26, the Chancellor of the Exchequer will deliver her budget to the House of Commons. The challenge she faces is all too evident. Last year's budget left the government with only £9.9 billion of headroom against the fiscal rules in 2029–30. All indications are that this headroom has disappeared and then some.

The precise size of the 'fiscal black hole' will not be known until the Office for Budget Responsibility's next Economic and Fiscal Outlook is published alongside the budget. However, independent forecasters suggest a gap in the tens of billions. This presents the Chancellor with three options: first, she could ignore or amend the fiscal rules; second, she could reduce public spending; or third, she could raise taxes. Of course, some combination of all three options is possible.

This briefing will examine the wider fiscal context surrounding the Autumn Budget 2025. It will look, firstly, at fiscal developments since the last budget in October 2024. Secondly, it will take a longer-term view of the public finances over the last thirty years. Thirdly, it will ask whether any fiscal gap could realistically be bridged solely by taxing the rich. Finally, it will assess the obvious alternative to tax increases: a reduction in public spending.

A second IEA Briefing Paper, published separately, will review in detail the various tax policy options facing the Chancellor at the upcoming budget.

How did we get here?

The Autumn Budget 2024 was the first delivered by a Labour chancellor since March 2010. In it, Rachel Reeves announced an additional £63.5 billion of spending in 2025–26, rising to £74.2 billion in 2029–30. To compensate, taxes would increase by £24 billion in 2025–26, rising to £41.2 billion in 2029–30¹. The combined effect of this and other changes to the economic and fiscal forecast meant that in 2028–29, public sector net borrowing (PSNB) would be 1 percentage point of GDP higher than previously

¹ HM Treasury, Autumn Budget 2024, Table 5.1: Policy Decisions.

forecast, while public sector net debt (PSND) would be 3 percentage points of GDP higher than previously forecast².

At the previous budget, delivered by Conservative Chancellor Jeremy Hunt, the then-government had left itself £8.9 billion of headroom against its primary fiscal target – to have PSND, excluding the Bank of England, falling as a percentage of GDP in the fifth and final year of the forecast. That compares to average headroom of £26.1 billion against the fiscal rules at previous budgets stretching back to 2010³. Plainly, the Conservative government was prepared to cut things very fine in order to afford a pre-election tax giveaway – their second, successive 2p cut to employee National Insurance.

Rachel Reeves did not give herself much more room for manoeuvre, leaving herself headroom against the fiscal mandate of only £9.9 billion. It is worth noting that Reeves also changed the fiscal rules in two important ways. The primary rule would now be to have the current budget in surplus by 2029–30. (This was stricter than the previous, supplementary rule that PSNB should be below 3% of GDP in the final year of the forecast.) This was accompanied by a supplementary target to have public sector net financial liabilities (PSNFL) falling as a percentage of GDP in 2029–30 (this was more relaxed than the previous, primary rule because PSNFL takes into account some publicly owned assets – whereas PSND does not).

Importantly, however, Rachel Reeves made her life more difficult in one crucial way. Previous fiscal rules had operated on a five-year rolling basis – so that the crucial year was *always* five years in the future. Under the new fiscal rules, once 2029–30 becomes the third year of the forecast window, the rules will operate on a three-year rolling basis. From the standpoint of sound fiscal management, this is an improvement. The previous system allowed too much fiscal ‘Augustinianism’ (as the OBR has described it): ‘Lord, grant me chastity and continence, but not yet.’⁴ A fixed target year for budget balance would be better than any rolling forecast, but a three-year rule is at least a step in the right direction. Still, whatever the principled advantages of the new fiscal rules, there is no doubt that they will act as an albatross around the government’s neck – absent some exogenous improvement in the trajectory of the public finances.

We have already had one official update on the public finances since the Autumn Budget 2024. This came at the Spring Statement in March 2025. At that stage, without

² OBR, Economic and fiscal outlook – October 2024, Table A.10: Fiscal aggregates: changes since March.

³ OBR, Economic and fiscal outlook – March 2024.

⁴ OBR, Economic and fiscal outlook – November 2017. Box 4.2.

taking into account any further policy decisions, the current budget was forecast to be £4.1 billion in deficit in 2029–30, rather than £9.9 billion in surplus⁵. The biggest driver of the change was higher debt interest payments, which were forecast to be £10.1 billion higher than previously anticipated in 2029–30. In response, the Chancellor announced a package of measures to restore the previous fiscal headroom. The largest single part of this package (saving £4.8 billion in 2029–30) was a set of welfare reforms, which would reduce eligibility for disability and incapacity benefits.

Most independent forecasters suggest that this headroom has subsequently been eliminated several times over. The government's belated reversal on winter fuel payments and welfare reforms is estimated to cost about £6 billion in 2029–30. Plans to eliminate the two-child benefit cap will likely cost £3.5 billion per year.

The thing that will have the biggest impact is a widely expected downgrade in the OBR's productivity growth forecasts. Since 2010, the OBR has famously been over-optimistic about productivity growth – assuming that a reversion to pre-financial crisis trends was just around the corner⁶. In fact, whereas productivity growth averaged 2.2% per annum before 2008, it has been 0.5–0.6% a year since 2010. The OBR's current medium-term forecast of 1.1% annual productivity growth is still much higher than the Bank of England's or most private-sector forecasters. But all indications are that this is about to change.

The productivity growth forecast is vital because it feeds through into wages, GDP, tax revenue and much else. As a result, each tenth of a percentage point that the OBR knocks off its medium-term productivity growth forecast is likely to lead to a £9 billion deterioration in the public finances⁷.

The consensus view seems to be that a two-tenths of a percentage point downgrade is most likely – suggesting a 2029–30 current budget deficit of around £20 billion. If you assume that the Chancellor will want to restore at least the 'fiscal rules headroom' she had at the last budget, that implies a fiscal gap of some £30 billion, which will have to be bridged by spending cuts, tax increases, or some combination of the two at the forthcoming budget – assuming that the fiscal rules are as sacrosanct as the government has hitherto maintained.

⁵ OBR, Economic and fiscal outlook – March 2025.

⁶ See IFS, OBR successive forecasts for productivity growth and out-turn, <https://ifs.org.uk/data-items/obr-successive-forecasts-productivity-growth-and-out-turn-index-2008-100>.

⁷ See IPPR, Navigating in the Fog, Technical Appendix, <https://www.ippr.org/articles/navigating-in-the-fog>.

Of course, while the fiscal rules are in some sense arbitrary, they do play an important signalling role and seem to be taken seriously by financial markets. Governments that openly flout them are likely to be judged more of a credit risk and face higher borrowing costs as a result. Since higher borrowing costs themselves drive higher spending and then (all things being equal) greater demand for debt, it is easy to see how a vicious cycle can take hold. The UK government already appears to be paying a premium on its borrowing compared to other major economies. With gilt markets in a somewhat febrile state, the government would surely be ill-advised to test lenders' patience.

The longer-term view

It would be misleading to suggest that Britain's fiscal problems are wholly, or even largely, the product of the current government's 15 months in office. Clearly, they have not helped themselves by increasing spending, ramping up borrowing and implementing tax increases that seem to have had a negative economic impact and produced disappointing revenue increases. Nevertheless, there is a longer-run story here that is worth considering.

When Tony Blair's government took office in 1997–98, it inherited a relatively strong fiscal position. That year, Total Managed Expenditure (TME) was 35.7% of GDP and Public Sector Current Receipts (PSCR) were 34.6% of GDP – resulting in a PSNB requirement of 1.1% of GDP. Initially, the government stuck to the outgoing Conservative administration's spending plans. PSNB was zero in 1998–99, –1.1% of GDP in 1999–2000, and –1.5% of GDP in 2000–01. In other words, the budget was balanced and then in surplus⁸.

Things began to change in the run-up to and aftermath of the 2001 general election, with PSNB averaging 3.2% of GDP from 2002–03 to 2007–08. In fairness, PSNB had averaged 3% of GDP over 18 years of Conservative government, so this was hardly unprecedented. The key difference was that TME fell by more than six percentage points of GDP under the Tories; from 2000–01 through 2007–08, TME rose by more than 5 percentage points of GDP.

⁸ Unless otherwise noted, all the data in this section is from the OBR's public finances databank 2024–25, <https://obr.uk/public-finances-databank-2024-25>. Author calculations have been employed where necessary.

The financial crisis and its immediate aftermath brought a dramatic shift in the fiscal picture, with TME surging from 40.2% of GDP in 2007–08 to 46.3% of GDP in 2009–10. PSCR fell over the same period, so that PSNB soared to 10.3% of GDP.

What followed was an extended effort to manage spending and borrowing back to its pre-crisis level. TME fell gradually, reaching 39.4% of GDP in 2018–19 and 39.5% of GDP in 2019–20. PSNB hit a post-crisis low of 2% of GDP in 2018–19. In the decade before the financial crisis, National Account Taxes averaged 33% of GDP. The same was true for the decade from 2010–11.

Then came the COVID-19 pandemic, which obliterated this decade of fiscal ‘progress’ almost overnight. TME spiked to 52.8% of GDP and PSNB to 14.9% of GDP. Spending has since fallen back, but not to anywhere near where it was. On current plans, TME will average 44.5% of GDP from the pandemic to the end of the decade. Even with the tax burden set to rise by more than two percentage points, PSNB does not return to its pre-pandemic low until 2029–30.

So here is one way you can tell this fiscal story. In the 2000s, public spending grew strongly, taking us from a surplus at the turn of the millennium to a small deficit on the eve of the financial crisis. Spending and borrowing rose in response to that crisis, and it then took more or less a decade of so-called austerity to get spending and borrowing back to where it had been before.

The pandemic repeated the trick – only more so. Spending (and borrowing) rose faster than in the financial crisis and, on current plans, has settled at a much-elevated level. We have gone from having a c. 35% of GDP state at the end of the 1990s to a c. 45% one at the end of the 2020s. The tax burden will have gone from c. 32% of GDP to c. 37.5% of GDP over the same period. But if spending is up by 10 percentage points of GDP and tax revenue by 5.5 percentage points, the result can only be a persistent deficit.

The role of economic crises in driving step changes in public spending, which prove difficult to reverse afterwards, is an important phenomenon to be aware of. It does explain much of the situation we have been in over the last 15 years. But there is another way to look at the last quarter-century of fiscal policy, which may also be instructive.

Leaving ideology aside, it may be considered reasonable to assume – as a baseline – that public spending should rise in line with inflation and population growth, after adjusting for demographic shifts. From 1997–98 to 2025–26, real public spending would

have had to rise by around 1% per year on average just to keep up with population change⁹.

Real economic growth over the same period has averaged 1.8% per year, so it would have been possible to meet this standard without raising taxes or borrowing more (overall). Indeed, it would have been possible, across the entire period, to 'share the proceeds of growth' between higher spending and lower taxes, as politicians sometimes like to promise.

In fact, however, the annual real terms growth in public spending over this period was 2.5% per year on average. The state has grown, the tax burden has risen, and large debts have been racked up because spending growth outstripped *both* demographic demand *and* growth in the economy needed to support it. Crises happen; Britain's policymakers cannot avoid all the blame for the current fiscal mess.

Two further points before moving on.

Firstly, there has been a pronounced slowdown in economic growth since the financial crisis. From 1997–98 to 2007–08, nominal GDP growth averaged 4.9% per year. From 2010–11 to 2019–20 and again from 2021–22 to the present day – excluding the 'crisis years' – nominal GDP growth has been approximately 4.2% a year on average.

If nominal GDP growth had continued at its pre-2008 average rate outside of the financial crisis and the pandemic, the economy would be some £380 billion larger today. The additional tax revenue generated by a much larger economy would easily eliminate the deficit, leaving room for both budget surpluses and tax cuts – even with current levels of spending in cash terms. Economic growth (or the lack of it) is also, therefore, an important part of the fiscal story.

Secondly, as well as looking at our fiscal past, we should consider our fiscal future. The OBR's 2022 Fiscal Risks and Sustainability Report contained an alarming set of long-term projections for the public finances¹⁰.

In particular, over the subsequent 50 years, without policy change, it anticipated that public spending on the over-65s would increase by 11 percentage points of GDP. A little over half of that was down to increased NHS spending driven by an older, and therefore sicker, population. About 4 percentage points could be attributed to increased spending

⁹ This is an estimate based on an analysis of the OBR's fiscal risks and sustainability reports.

¹⁰ OBR, Fiscal risks and sustainability – July 2022.

on pensions and other pensioner benefits. The rest was down to increased spending on adult social care¹¹.

To put this in perspective, 11 percentage points of 2021–22 GDP would have been £260 billion – comfortably more than income tax and capital gains tax revenue that year (£240 billion)¹². Imagine doubling everyone’s direct personal tax bill, and you get a sense of the scale of the problem.

Now, this is obviously not the issue at hand at the forthcoming budget. Fifty years is a very long time in fiscal policy, and a huge amount could change over such a period. (That being said, if the OBR does now expect productivity growth to be permanently lower than before, that will significantly reduce long-run GDP and so make the relative fiscal impact of an ageing population much, much worse.) The reason these long-run fiscal projections are worth bearing in mind is simple: if we cannot get spending under control and balance the books *now*, what hope do our children’s and grandchildren’s generations have?

Can we just tax the rich?

There is a sense among many on the political left, and perhaps quite a few in the uninformed middle, that none of this is really a problem because any fiscal gap can be bridged simply by taxing other people – namely, the rich. This, however, is a dangerous fantasy.

Let’s start with the most obvious way to tax the rich – increasing the top (additional) rate of income tax, which is paid on income in excess of £125,140, from 45p to some higher level. The trouble here is that according to HMRC, each 1p increase in the additional rate of income tax only yields £145m in 2026–27, £265m in 2027–28, and £230m in 2028–29¹³. Even if you leave aside the certain fact that much higher rates would yield diminishing marginal returns, there is no possible additional rate of income tax that would generate the tens of billions needed to stick to the fiscal rules. (On paper, the HMRC numbers suggest that adding 13p to both the higher and additional rates – taking them to 53 and 58p, respectively – would generate around £31 billion. However, this is

¹¹ A more detailed analysis is provided by Karl Williams in CPS, Justice for the Young, The Age Gap, <https://cps.org.uk/research/justice-for-the-young>.

¹² Author calculations based on the OBR’s public finances databank 2024–25.

¹³ HMRC, Direct Effect of Illustrative Tax Changes (June 2025), <https://www.gov.uk/government/statistics/direct-effects-of-illustrative-tax-changes>.

unlikely to be the case once a full behavioural response is factored in. Furthermore, it is not clear that those advocating higher taxes on ‘the rich’ really intend senior nurses, junior doctors and experienced state school teachers to face such punitive marginal rates of income tax.)

The position of additional rate income taxpayers more broadly is helpful to consider in this context. They represent just 3% of income taxpayers¹⁴. They are responsible for, perhaps, 19% of pretax income¹⁵. And yet they are also responsible for 38% of the revenue from income tax on earnings, 55% of the revenue from income tax on dividends, and 70% of the revenue from income tax on savings. (This works out to about 40% of income tax revenue overall.)

Additional rate taxpayers face an average income tax rate of 37.4%, which is exactly twice the average tax rate faced by income taxpayers as a whole. (The average income tax rate for basic rate taxpayers is 10.3%; for higher rate taxpayers, it is 20.7%.)

Indeed, one underappreciated element of the UK income tax system is that it has become much more progressive since the financial crisis – despite a supposedly wealth-friendly Conservative Party leading-government across most of that period. In 2007–08, the top 10% of income taxpayers paid 54.3% of income tax; the top 5%, 43.4%; and the top 1%, 24.4%. In the current tax year, those figures are projected to be 58.6%, 47.1%, and 26.6%, respectively.

And this has happened while the share of *pretax* income attributable to these taxpayers has actually *fallen*: from 36% to 34.4% for the top 10%; from 26.4% to 24.9% for the top 5%; and from 13.4% to 12.6% for the top 1%.

Some will reasonably object at this point that income tax is only one element of the tax system (admittedly, by far the largest one). What about capital gains tax (CGT)? Here the top-heavy nature of our tax system is even more pronounced. In 2023–24, taxpayers with gains in excess of £1m – fewer than 3% of those with taxable gains – were responsible for roughly 64% of total capital gains tax revenue. Indeed, the tiny fraction of those subject to CGT with gains over £5m in 2023–24 paid 40% of the tax¹⁶.

¹⁴ Numbers here are taken from HMRC, Income Tax Liabilities Statistics, <https://www.gov.uk/government/statistics/income-tax-liabilities-statistics-tax-year-2022-to-2023-to-tax-year-2025-to-2026>.

¹⁵ Publicly available government statistics do not actually provide this number. They tell you that the top 1% of income taxpayers is responsible for 12.6% of pretax income, and the top 5% for 24.9%. The figure given here is derived by fitting a curve to the available data and using this to estimate the pretax income share of the top 3% of income taxpayers.

¹⁶ HMRC, Capital Gains Tax statistics, Table 2: Estimated number of taxpayers, amounts of gains and tax liabilities by size of gain, <https://www.gov.uk/government/statistics/capital-gains-tax-statistics>.

Of course, it is true that the rates of CGT are lower than those of income tax. Many people, not exclusively on the political left, argue that these rates should be aligned – partly as a matter of fairness and partly to raise more revenue. In 2018–19, HMRC analysis suggested that full rate-alignment would raise approximately £14 billion (on a static basis)¹⁷. Simply uprating with inflation would make that about £18 billion today. Would this be a sensible way to raise significant additional revenue from the rich?

The problem with that point of view is that there are compelling economic reasons to treat capital gains differently from ordinary income:

- Firstly, gains are often the result of investments made out of taxed income; unless tax relief is given when the investment is made, taxing gains at income tax rates will constitute double taxation and create a structural bias against investment (or deferred consumption) in the tax system.
- Secondly, gains can sometimes be a ‘paper’ phenomenon, reflecting inflation rather than a real return on investment; unless gains are indexed to inflation, taxing them at income tax rates may mean that investment income is overtaxed relative to labour income.
- Thirdly, the flipside of gains are losses; if you tax capital gains like ordinary income and do not make losses fully deductible, then, again, you are creating a tax bias against investment.
- Finally, the vast majority of capital gains come from business assets and so reflect corporate earnings that have already been (or will subsequently be) subject to corporation tax; unless you adjust the CGT rate on these assets to reflect the impact of corporation tax, another tax bias against investment is introduced into the system.

Neutrality in the tax system towards saving and investment is important because our future prosperity depends on capital accumulation. Investment drives innovation, productivity and growth. A tax system that is biased against it is therefore an act of economic self-harm – one that a country with a stagnant economy and comparatively low levels of investment can ill afford.

It follows from the analysis above that if you are going to tax capital gains at the same rates as ordinary income, then from an economic standpoint you should also introduce

¹⁷ See Office of Tax Simplification, Capital Gains Tax review – first report: Simplifying by design, p. 35. The OTS also note, ‘However, it is clear that nothing like this amount would be raised in practice, due to behavioural effects (such as people delaying disposals) and other changes that might be made in parallel (such as allowing for inflation).’

up-front tax relief when investments are made, indexation for inflation, full tax-deductibility for capital losses and some sort of credit-imputation system to reflect the prevailing rate of corporation tax. Such a system would, arguably, be more rational than just taxing capital gains at a (randomly chosen) lower rate than 'earned' income. On the other hand, these adjustments would increase complexity and significantly reduce the amount of additional revenue raised. CGT does not offer a pain-free route to much higher taxes on the rich.

It is also worth pointing out that CGT is in some sense 'optional' – in the sense that you can avoid it by not selling an asset and so not realising the capital gain. Given the huge instability in CGT policy in recent decades, many investors will be inclined to gamble on a future government reversing course and adopting a more 'attractive' regime. Indeed, this well-known 'lock-in effect', according to which asset disposal decisions become linked to tax considerations rather than market ones, is itself a major distortion caused by CGT. (Some argue for taxing unrealised gains on a mark-to-market basis in response, but such proposals are fraught with practical difficulties.)

There is an international competitiveness angle here, too. According to the Tax Foundation's latest International Competitiveness Index, nine out of 38 OECD countries do not tax capital gains (from the sale of shares in listed companies) at all¹⁸. Britain's CGT rate currently puts it in the middle of the pack (22nd lowest) among OECD countries, but aligning with income tax (and adopting a top rate of 45p) would put us in a very bad position relative to our peers – no other OECD country levies a rate that high. Our top dividend tax rate (39.4%) is already the fourth-highest in the OECD.

As a rule, capital is mobile. Many businesses and investors are sensitive to tax considerations. It may be the case that an 'exit tax' would prevent existing capital from fleeing in response to higher CGT rates, but of course that does not tell you much about how investors and would-be entrepreneurs will behave in the future. If they rationally choose to steer clear of Britain, a CGT raid could end up looking very short-sighted.

Obviously, there are lots of countries – including many of our Western European neighbours – who raise more tax revenue, as a percentage of GDP, than we do. Some of these countries do indeed have higher taxes on 'the rich' (though this is not uniformly the case). However, it is not the way these countries tax the well-off that makes the difference. Nor, for the avoidance of doubt, is the difference explained by property taxes, consumption taxes or corporation tax¹⁹.

¹⁸ Tax Foundation, International Tax Competitiveness Index 2025, Appendix Table B.

¹⁹ For a good assessment of this question, see Institute for Fiscal Studies, How do other countries raise more in tax than the UK? <https://ifs.org.uk/publications/how-do-other-countries-raise-more-tax-uk>. The

What does change the picture is the way other countries tax ordinary earners. In particular, they tend to raise much more from social security and payroll taxes than we do. Copying them would mean much higher employer and employee National Insurance contributions, which would significantly affect middle-income workers. By way of compensation, many of the countries in question also have benefits systems that are strongly linked to contribution, rather than being exclusively means-tested.

Whether or not Britain should adopt this ‘continental’ approach to tax (and benefits) is a valid debate to have. But it is a very different proposition from simply raising taxes on the rich to fill the government’s fiscal black hole.

Could we just reduce public spending?

We must not let the endless speculation about higher taxes (or, indeed, political reality) blind us to the fact that there is an obvious alternative: reducing planned public expenditure. But how much would spending have to fall? And what – in big-picture terms – might such an effort entail?

Let’s start with the planned number for TME in the current fiscal year, 2025–26: £1,347.2 billion. If you assume that TME was to rise each year in line with the previous year’s CPI inflation, then, following increases of 3.2%, 2.1%, 2%, and 2%, TME would reach £1,476.9 billion in 2029–30 – the year that matters when it comes to the fiscal rules. In fact, planned TME in 2029–30 is £1,519 billion – just over £42 billion higher than the pure ‘inflation-adjusted’ total²⁰.

In other words, if public spending rose only with inflation between now and 2029–30, the public finances would be improved by more than £40 billion. That may be all that Rachel Reeves needs to double the previous amount of headroom against her fiscal rules.

Is it really so simple? Perhaps not. There are various ways you can break down TME, but one meaningful distinction is between Annual Managed Expenditure (AME) and Departmental Expenditure Limits (DELs). AME includes things like debt interest, public sector pensions, the state pension, universal credit and disability benefits – all things

data used there is out-of-date, but the conclusions still hold. Various OECD datasets and reports can be used to explore this issue in greater detail.

²⁰ Numbers here are based on HM Treasury, Spring Statement 2025 and author calculations.

that are hard for the government to control on a year-to-year basis *without* major policy changes. Departmental spending is much easier to manage.

So, let's say, for the sake of argument, that AME continues to 2029–30 as forecast at the Spring Statement. This would mean that, to keep spending stable in real terms *overall*, departmental spending would have to be cut by £20 billion per year (or 2.5%) in real terms by 2029–30. That makes the challenge look a little harder, but still not unmanageable.

But we can add a further consideration. Let's say that spending on NHS England – more than a third of total departmental spending at the moment – continues to grow at 4% a year in real terms, as it did from 2023–24 to 2025–26. (To be clear, this is *not* a recommendation; it is just an assessment of political priorities for illustrative effect.)

Protecting NHS spending in this way has a significant effect on the overall picture. If spending on NHS England rises by 17% between now and 2029–30, and departmental spending has to fall by 2.5% in real terms *overall*, that would mean cutting non-NHS departmental spending by 14% a year in real terms by 2029–30. That would be a significant undertaking for any government.

Of course, this is just one highly stylised way of looking at public spending. In reality, AME is not a foregone conclusion: debt interest payments could fall if inflation and borrowing were lower; welfare can and should be reformed to reverse the large, post-pandemic increase in working-age sickness-related benefits; at some point, given the demographic pressures we face, government will have to rethink the triple lock and the generosity of public-sector pensions. A serious, structural reform of the NHS might reduce its insatiable appetite for taxpayer cash. On the other hand, there are plenty of policy areas where people across the political spectrum might argue for higher spending – the defence budget is one non-trivial example.

The point, then, is not to dismiss the idea of meeting the fiscal rules through spending restraint. Doing so is not impossible or even unrealistic. And as a rule, it is much better to let people spend their own money on the things they want, rather than having the government do it for them. However, it is important to acknowledge that spending-driven fiscal balance is unlikely to be achieved simply by identifying a few 'inefficiencies' in Whitehall or by abolishing a few headline-grabbing government programmes (think Motability, or DEI).

In fact, sustainably lower public spending will only come about as the result of meaningful structural reform across multiple areas of government. The state must *do* less – not just spend less – if we want to balance the books this way.

Conclusion

Even if, as is rumoured, the latest OBR forecasts have slightly improved the fiscal outlook, the Chancellor still faces a significant challenge at the forthcoming budget. It appears she will have to eliminate a 2029–30 budget deficit of around £20 billion while also restoring at least the previous ‘headroom’ against the fiscal rules of roughly £10 billion. Some reports suggest Rachel Reeves will want to create greater headroom this time, to avoid the risk of being back in the same position next year, should economic conditions deteriorate again. In other words, we should expect a fiscal ‘tightening’ of at least £30 billion by 2029–30, relative to current plans, at the budget.

The best way to bridge any such fiscal gap is through reduced public spending. You would not know it from recent media commentary, but this approach is entirely plausible. Just keeping overall spending increases in line with inflation for the next few years would do the trick. Yet there are a variety of structural factors that create real upward pressure on spending. Restraint will require genuine reform of public services and the state – but just the usual Whitehall rigmarole.

Taxing the rich more is unlikely to help. There are not enough of them, and raising the necessary sums would entail marginal rates so high (on a static basis) that they are bound to be counterproductive (on a dynamic one). The British tax system is already very top-heavy in revenue terms and not especially competitive by international standards. A CGT raid or – worse – an attempt to tax wealth directly would surely lead to a significant outflow of productive talent and undermine future homegrown entrepreneurship.

Ultimately, in both tax and spending, we ought to take a long-term view. For tax, that means a genuine effort to simplify and rationalise the system while making it more pro-growth. Our highly politicised budget process makes that kind of policymaking difficult. On the spending side, we need to recognise that our fiscal problems did not appear overnight and will not be solved at a single budget. Indeed, putting Britain on a sound fiscal footing – not just for 2029–30 but for the next generation – is a mission that could and probably should occupy a whole government across an entire Parliament. We can put off that day of reckoning, but we cannot avoid it forever.