

# Why the UK's Fiscal Charter is doomed to fail: A...

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I have a new paper, co-authored with Prof Ronen Palan [on the web site of the City University Political Economy Research Centre](#) today. This, at 30 pages, is a chunky price of work encompassing a lot of data for a twenty plus year period (15 historic, the rest projected) which looks at what has really happened with austerity in the UK.

In summary, in the paper we look at:

- \* UK tax revenues broken down by type for the last 15 years, and forecast for the next five;
- \* UK government spending analysed in various ways, including by department, by current spending and investment spending and split between delegated department spending (RDEL) and annually managed expenditure (AME);
- \* Sectoral balances.

As a result of the work we conclude:

- \* That over spending did not cause the crash;
- \* That although it looked as if revenue crashed in 2008 with a slow recovery ever since this is not a fair representation of economic reality: as a proportion of GDP revenues have been remarkably flat line (and are expected to be) for two decades although their composition has changed significantly;
- \* Although in constant prices spending looks to virtually flatline from 2010 to 2020 this also misrepresents reality: as a proportion of GDP government spending has fallen by about 0.8% per annum, almost constantly, and is still forecast to do so, whilst when stated on a per capita basis the story is much more complicated and shows we have already suffered a significant period of austerity that is about to get much worse and that perceptions of that austerity are likely to increase markedly.

That per capita analysis is as follows

This suggests:

- \* Current government spending the capital fell very little until 2012 — 13: the impression of austerity in total spending until 2013 was created by cutting investment;
- \* In contrast, from 2013 onwards has been a steady decline in current spending per head which is only going to reverse in 2020, or thereabouts;
- \* The composition of that current spending is also changing dramatically: until 2011 — 12 plan department spending (RDEL) on things like health, education, transport, the police, and so on (all of which create a taxpayer feel-good factor) exceeded annual managed expenditure (welfare, debt interest, et cetera). Now these two have reversed and that trend will continue most markedly as planned expenditure is cut by around 25% during the course of this Parliament. There has, then, been a massive distributional change in the way in which government expenditure takes place which many middle income taxpayers will feel is not to their advantage;
- \* At the same time that this changes occurred the government is forecasting that between 2015 and 2020 national insurance and income tax receipts will rise at a rate significantly above GDP growth (whether stated in real or nominal terms) whereas VAT will only grow consistently with GDP growth and corporation tax receipts will fall against that measure;
- \* The consequence of this is that there will be many people who feel that they are losing out from the redistribution of government spending towards annual managed expenditure whilst at the same time they will be asked to make a bigger income tax and National Insurance contribution and yet companies will appear to be gaining. The opportunity for significant social stress to arise as a consequence of these changes is obviously very high.

In addition to these facts we have also looked at the probability that George Osborne can actually deliver the restructuring of the UK's balance sheet so that he can eliminate borrowing by the end of this Parliament. We believe that this can only be achieved if:

- \* There is 6% house price growth to fuel the growth in private sector household borrowing to levels in excess of those witnessed in 2008 as a proportion of GDP;
- \* If business can be persuaded to borrow to consistently invest over the next few years at rate generally much higher than those witnessed since 1980;
- \* The overseas sector substantially changes its behaviour so that our balance of trade improved significantly in financial inflows into London reduce.

In our opinion none of these events is likely. The only reason, we think, that the OBR can forecast the possibility of a balanced budget is that they continue to assume, as they did in 2010, that the multipliers applying to government spending vary between 0.3 and 1 whereas the IMF think that they might be as high as 1.7 and Standard &

Poor's think they could even exceed two.

The result is that we believe that there is very little chance at all that the promise included in the Fiscal Charter of a balanced budget by 2020 can be achieved. If the errors of forecasting are in fact as big as we expect it is possible that there could still be a deficit of almost £40 billion a year instead of the forecast £10 billion surplus at the end of this parliament.

This means that in combination:

- \* There will be substantial stress as a result of the reduction in managed expenditure;
- \* This will be particularly felt by those who might be asked to pay more income tax while such cuts are going on;
- \* These people's perception of dissatisfaction will grow as it becomes apparent that the likelihood of a balanced budget is diminishing into the future, as has always been the case since 2010 because of the poor choice of multipliers for forecasting purposes;
- \* Significant political and even social stresses might result;
- \* The government appears to be attempting to manage a political as well as an economic cycle and both are high risk strategies that appear to include a significant chance that they might go wrong;
- \* And all of that is before any risk of a further downturn imported as a result of increasing difficulties in the emerging markets is taken into account.

The paper may well develop: comments are welcome.