HM Treasury

Government Response to the 2023 Fiscal Risks and Sustainability Report

November 2023

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Introduction

1. The Office for Budget Responsibility's (OBR) 2023 Fiscal Risks and Sustainability Report (FRS) is the second integrated report on fiscal risks and sustainability. The OBR's analysis provides a comprehensive overview of the public finances by uniting into one report the interplay between short-term fiscal risks with the longer-term outlook for the public finances. The International Monetary Fund (IMF) commented that the OBR's risks reports have raised "the bar on the assessment and quantification of fiscal risks to a new level that other countries should look to meet".[1]

2. This year's FRS examined three main risks to the public finances: Inactivity and Health; Energy; and Debt Sustainability. It also provided an update on other risks in its fiscal risks register.

3. This government response to the FRS sets out the actions the government is taking to address risks to the public finances, as part of the government's commitment to fiscal sustainability.

4. As the OBR highlights in its report, the UK has, in common with other countries around the world, experienced a rapid succession of shocks in recent years. Most recently, Putin's illegal war in Ukraine and global supply chain pressures have contributed to higher energy prices and the global surge in inflation. In response, increases in interest rates by central banks have pushed up the cost of borrowing for families, businesses, and governments everywhere.

5. In the UK, the government has acted to support households and businesses through these shocks, including through energy support schemes and targeted cost of living support, while taking fiscally responsible decisions to ensure the public finances are on a sustainable footing.

6. The government has consistently acted decisively and responsibly to mitigate risks to the public finances, including those assessed in the FRS report. The government has a comprehensive plan for tackling health-related economic inactivity, and Autumn Statement 2023 builds on the major policy package the government announced at Spring Budget 2023 to support people stay in work or get back into work.[2, 3] While energy prices have recently fallen, they remain elevated largely because of Russia's invasion of Ukraine. To increase the UK's resilience to future energy price shocks and reduce our reliance on

1 Stressing the Public Finances – the UK Raises the Bar, International Monetary Fund, July 2017

2 Autumn Statement 2023,, HM Treasury, November 2023

3 Spring Budget 2023, HM Treasury, March 2023

energy imports, the government is committed to decarbonising the power sector and transitioning to domestic clean energy sources.

7. The government is committed to sustainable public finances and providing the foundations for long-term growth. The fiscal rules ensure debt is falling. The FRS, and this government response, is part of the government's effective fiscal risk management framework, which ensures that interactions between risks to the macroeconomic outlook, financial systems, and public finances are considered in the round.

8. The government has announced that it will provide up to £10 million funding over 2024-25 and 2025-26 to finance research on risks to the economy and public finances. In addition, the Contingent Liability Central Capability has published the first report detailing the government's existing total exposure to guarantees, insurance and provisions, helping the government manage these important non-debt liabilities better.

9. Taken together, this risk framework keeps the UK at the forefront of best practice in managing and monitoring fiscal risks.

Inactivity and Health

10. Rising inactivity has put significant pressures on the fiscal position of the UK. Since the pandemic, labour market inactivity has risen sharply and, despite falling from its pandemic peak of 9 million in July 2022, it still remains over 350,000 above pre-pandemic levels in Q3 2023, based on recent experimental estimates.[4] This is explained by the increase in inactivity due to long-term sickness and disability which was at a record 2.6 million in the latest published data for the 3 months to July 2023, 491,000 above pre-pandemic levels.[5]

11. A healthy population is key for ensuring a strong economy and public finances. The FRS associates the rise in health-related inactivity and in-work ill health since the onset of the pandemic with an estimated annual reduction in tax of £8.9 billion in 2023-24 and an estimated increase in welfare spending of £6.8 billion in 2023-24.[6]

12. Supporting working-age people back into work is a priority for the government. That is why at Spring Budget 2023 the government announced a package that targeted support at groups where inactivity levels were high or where employment support was most needed, including the long-term sick and disabled, welfare recipients, people aged over 50, and parents (Box 1).

13. This included a £406 million package over the next five years to tackle the leading health-related causes keeping people out of work, with investment targeted at services for mental health, musculoskeletal conditions and cardiovascular disease. This action plan included an ambitious programme of digitisation to introduce free access for digital resources for management of mental health and musculoskeletal conditions, so that more people can easily and quickly access the support that is right for them.

14. The OBR forecast that the Spring Budget 2023 package will have resulted in 110,000 more individuals in the labour market by the end of the forecast period, which will increase potential output by 0.2% in 2027-28.[7] At the time, the OBR noted that this was the largest permanent increase in potential output the OBR had ever scored in a medium-term forecast as a result of government policy.

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[4] UK Labour Market: November 2023, Office for National Statistics, November 2023

[5] UK Labour Market: November 2023, Office for National Statistics, November 2023

[6] Fiscal risks and sustainability, Office for Budget Responsibility, July 2023

[7] Economic and fiscal outlook, Office for Budget Responsibility, March 2023

Box 1: Spring Budget 2023 labour market package

This Spring Budget 2023 package included measures targeted to support those with health conditions:

- A new Universal Support programme, which matches disabled people and those with health conditions in England and Wales with existing vacancies.
- Publishing the Health and Disability White Paper, which set out plans to reform the welfare system to better meet the needs of disabled people in Great Britain. This includes abolishing the Work Capability Assessment (WCA) and supporting claimants to try work without fear of losing their financial support.
- Expanding the forthcoming Small and Medium Enterprise (SME) occupational health subsidy pilot scheme and launching a consultation on options to boost Occupational Health (OH) provision by employers, increase the supply of OH professionals, and expand OH tax reliefs.
- A suite of policies to support people with long-term health conditions access the services they need to return to or remain in employment, including embedding tailored employment support within mental health and musculoskeletal services, introducing an ambitious programme of digitisation covering mental health, musculoskeletal, and cardiovascular services to support management of long-term health conditions, and expanding the Individual Placement and Support (IPS) scheme which supports people with severe mental illness into employment.

15. This was the beginning of a journey of reforms that the government recognises are necessary to tackle increasing health-related inactivity. The government agrees with the FRS conclusions that it is vital to improve health outcomes and better address incentives within the benefits system for individuals, in order to effectively tackle the record rises in health-related inactivity.

16. At Autumn Statement 2023, the government is building on this work, which includes announcing the Back to Work Plan: helping more people who are long-term sick and disabled or long-term unemployed enter and stay in work. The OBR judges that the Autumn Statement package will not only bring 78,000 additional people into employment by the end of the forecast period, but also will significantly increase the

numbers of hours worked in the economy, as existing workers increase their hours as a result of policy changes.[8]

17. The government's proposed reforms involve a significant expansion of employment support and available treatments, reform to the way people who fall ill interact with the state and closer collaboration between employers and the government to improve employees' health.

18. Specifically, this will involve expansion of Talking Therapies, Individual Placement and Support for severe mental illness and Universal Support. The government will also reform the activities and descriptors in the Work Capability Assessment and explore end-to-end reform of the fit notes process alongside exploring new voluntary occupational health standards.

19. In addition to these specific policies, improving access to both primary and secondary care is a key government priority in order to ensure people can get the support they need to reduce the number who are out of work due to ill health. The government is doing this by:

- Making it easier and quicker for the public to get the help they need from primary care, as outlined in the Primary Care Recovery Plan published in May. The government is also investing at least £1.5 billion to create 50 million more GP appointments a year by 2024.
- Taking steps to tackle the backlog of NHS elective activity and improve urgent care performance. The government announced over £8 billion at Spending Review 2021 to create the Elective Recovery Fund, which has helped to virtually eliminate waits of over 2 years and 18 months respectively.[9, 10] At Autumn Statement 2022, the government committed a further £8 billion in 2024-25 for the NHS and adult social care, supporting the commitments on A&E and ambulance waiting times set out in NHS England and the Department for Health and Social Care's (DHSC) Delivery Plan for Recovering Urgent and Emergency Care Delivery Plan published in January 2023.[11, 12]
- Ensuring the NHS has the workforce it needs for the future, as set out in the NHS Long Term Workforce Plan published in June 2023, which is backed with £2.4 billion over the next five years to fund additional training places.

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8 Economic and Fiscal Outlook, Office for Budget Responsibility, November 2023

9 Autumn Budget and Spending Review 2021, HM Treasury, October 2021

10 Delivery plan for tackling the COVID-19 backlog of elective care, NHS England, February 2022

11 Autumn Statement 2022, HM Treasury, November 2022

12 Delivery plan for recovering urgent and emergency care services, NHS England and Department for Health and Social Care, January 2023

20. More widely, the government remains committed to supporting people to live healthier lives. For example, the government published a policy paper in October setting its ambition to create a smokefree generation by raising the age of sale by one year, every year for this generation, so children turning 14 or younger this year will never be able to be legally sold cigarettes, which will eventually translate into cost savings to the NHS.

21. In June 2023, the government announced a two-year pilot backed by up to £40 million to explore ways to make obesity drugs accessible to eligible patients living with obesity outside of hospital settings. The government has taken further action to tackle obesity, including introducing calorie labelling on menus (from April 2022), which is expected to bring health benefits of £4.6 billion and provide NHS savings of £430 million over the next 25 years, and restrictions on the location of less healthy foods in shops (from October 2022), which are expected to bring health benefits of over £57 billion and provide NHS savings of over £4 billion over the next 25 years.[13]

[13] New drugs pilot to tackle obesity and cut NHS waiting lists, HM Government, June 2023

Energy

22. High and volatile energy prices pose a risk to households, businesses and the public finances. As a net importer of gas, the UK remains vulnerable to changes in wholesale gas prices. Following Russia's invasion of Ukraine, wholesale gas prices peaked at thirteen times their historical level in August 2022.[14] Gas prices have fallen significantly since then but remain volatile.

23. Continued dependence on gas could be as expensive fiscally as completing the transition to net zero. The FRS shows that, in an adverse scenario if periodic spikes in gas prices were to continue in the long run, then continued dependence on gas could "add around 13 per cent of Gross Domestic Product (GDP) to debt by 2050-51".[15] This is almost twice the OBR's central estimate for the cost of the total public investment needed to complete the net zero transition by 2050.

24. Transitioning to net zero is therefore critical to reducing fiscal costs and addressing the risks associated with continued exposure to gas price volatility as well as climate change. The FRS also suggests that higher gas prices could present a fiscal opportunity by making renewable energy sources relatively cheaper to adopt, thereby further reducing the government's fiscal burden from transitioning to net zero.

25. The UK has made rapid progress in decarbonising over the last three decades. Between 1990 and 2021, UK emissions fell by 48% while our economy grew by 65%, decarbonising faster than any other G7 country.[16] The UK has already met, and overachieved, against its first (2008-2012) and second (2013-2017) carbon budgets and is expected to significantly overachieve on the third (2018-2022).[17]

26. The FRS notes that the increase in market prices led to a 15% decrease in gas consumption, controlling for temperature. At face value this is a positive development for decarbonisation and reducing gas dependence. However, there is not yet compelling evidence to explain how much of this demand reduction is temporary (for example, consumers heating their property to a lower level than they would prefer) or permanent (for example, investment in smart thermostats and insulation).

27. The government has set out detailed plans for the UK's energy transition in the Net Zero Review and Net Zero Strategy (2021), the

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[14] Fiscal risks and sustainability, Office for Budget Responsibility, July 2023

[15] Fiscal risks and sustainability, Office for Budget Responsibility, July 2023

[16] Carbon Budget Delivery Plan, HM Government, March 2023

[17] Energy and Emissions Projections, Department for Energy Security and Net Zero, October 2023

British Energy Security Strategy (2022), and the Net Zero Growth Plan (2023).[18, 19, 20] Mobilising Green Investment: 2023 Green Finance Strategy also sets out how the UK government is working with a range of public financing bodies to commercialise and finance the green technologies needed for the transition, complementing steps taken through Powering Up Britain, to deliver cheap, clean British energy sources to heat homes and power industries.[21]

28. In September 2023, the Prime Minister provided further detail on how the government will ensure the transition is undertaken in a way that limits the burdens on consumers.[22] For example, the government will support households to make the switch through the Boiler Upgrade Scheme, which gives people cash grants to replace their boiler. This has been increased by 50% - from £5,000 to £7,500 - further incentivising the uptake of electric heat pumps to replace gas boilers and further reducing the UK's gas dependence.

29. To support deployment of low carbon technologies and boost the UK's domestic energy security the government has, alongside Autumn Statement 2023, responded to the review by the Electricity Network Commissioner Nick Winser. The government's action plan will halve the time it takes to build new electricity network infrastructure, enabling green low carbon energy projects to connect sooner. The government is also tackling the current long waits to connect to the grid by announcing reform of the grid connection process, so that power generation projects such as wind and solar farms can get the connections they need more quickly.[23] The government has also increased the maximum price available to renewable energy projects at the next Contracts for Difference auction.[24]

30. In addition, the government has published its response to the National Infrastructure Commission's (NIC) study on the infrastructure planning system, which fully accepts the ambition of all of the NIC's recommendations.[25] This, alongside existing government reforms as part of the Nationally Significant Infrastructure Project Action Plan, will significantly reduce consent times for major energy infrastructure projects, such as offshore wind.[26]

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18 Net Zero Strategy: Build Back Greener, HM Government, October 2021

19 British Energy Security Strategy, HM Government, April 2022

20 Powering Up Britain: The Net Zero Growth Plan, HM Government, March 2023

21 Mobilising Green Investment 2023: 2023 Green Finance Strategy, HM Government, March 2023

22 Press release, HM Government, September 2023

23 Transmission Acceleration Action Plan, Department for Energy Security and Net Zero, November 2023

24 Press release, Department for Energy Security and Net Zero, November 2023

25 Government response to the National Infrastructure Commission's report on Delivering net zero, climate resilience and growth: improving nationally significant infrastructure planning, HM Government, November 2023

26 Nationally Significant Infrastructure Projects (NSIP) reforms, Department for Levelling Up, Housing & Communities, February 2023

Debt Sustainability

31. The government's approach to debt sustainability is based on a clear fiscal framework which is set out in the Charter for Budget Responsibility. This framework outlines the government's approach to getting debt falling and to managing debt in a way that minimises government financing costs over the long term, taking into account risk.

32. Thanks to responsible management of the UK's public finances, the government was able to provide unprecedented support to businesses and households in the face of a rapid succession of shocks in recent years. But the "once-in-a-century" shock of the pandemic and "once-in-a-generation" energy crises caused by Putin's illegal invasion of Ukraine have pushed debt and borrowing to historic highs. High inflation and interest rates have added to the challenge by increasing the cost to service the national debt.

33. The government is committed to getting debt falling. Sustainable public finances provide the foundations for long-term growth. Reducing debt provides space to respond to future shocks, reduces the burden passed onto our children and grandchildren and reduces spending on debt interest.

34. Since the OBR's March 2023 forecast, the medium-term fiscal outlook has improved. The government is delivering on the Prime Minister's economic priorities, with debt forecast to fall as a share of GDP over the medium term.

35. The OBR has confirmed in its November 2023 forecast that the government is on track to meet its borrowing and debt fiscal rules. Borrowing is below 3% of GDP three years ahead of target and underlying debt falls in the fifth year of the forecast. Headroom against both the borrowing and debt rule has also improved.

36. The government is taking long-term decisions for sustainable public finances. By making full expensing permanent at Autumn Statement 2023, the government is recognising the higher short-term fiscal cost of this measure, but this cost will decline over time while the increase to business investment will increase GDP in the long term.[27]

37. Looking beyond the main measures of debt and borrowing, the government considers a broader set of fiscal measures as part of its commitment to fiscal sustainability. Since 2021, the Charter for Budget Responsibility has included an aim to strengthen over time a range of measures of the public sector balance sheet. The government takes

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[27] Economic and Fiscal Outlook, Office for Budget Responsibility, November 2023

into account the entire public sector balance sheet by actively monitoring forecasts of public sector net worth and public sector net financial liabilities. The government's commitment, as set out in Autumn Statement 2022, to publish a balance sheet report to examine the management of public sector assets and liabilities is a further step towards building the most comprehensive view of what the public sector is worth. The holistic approach that the government has taken in designing its fiscal framework and ensuring that its objectives are met in a sustainable way means the UK continues to be at the forefront of international best practice in the management of the public finances.

38. There are long-term challenges for the public finances: structural changes to the economy caused by an ageing population, climate change and the transition to net zero are expected to put upward pressure on public spending and pose risks to the tax base over the coming decades. Without action, the FRS 2023 projections show public sector net debt reaching 310% of GDP by 2072-73, 31 percentage points higher than the FRS 2022 projections. This is largely because of a higher starting point for debt and expectations of persistently higher interest rates.

39. Without the government's action to date, this long-term outlook would be worse. The FRS notes that the government's decisions to improve the primary balance contributed to a "39 per cent of GDP reduction to debt by the end of our projection period".

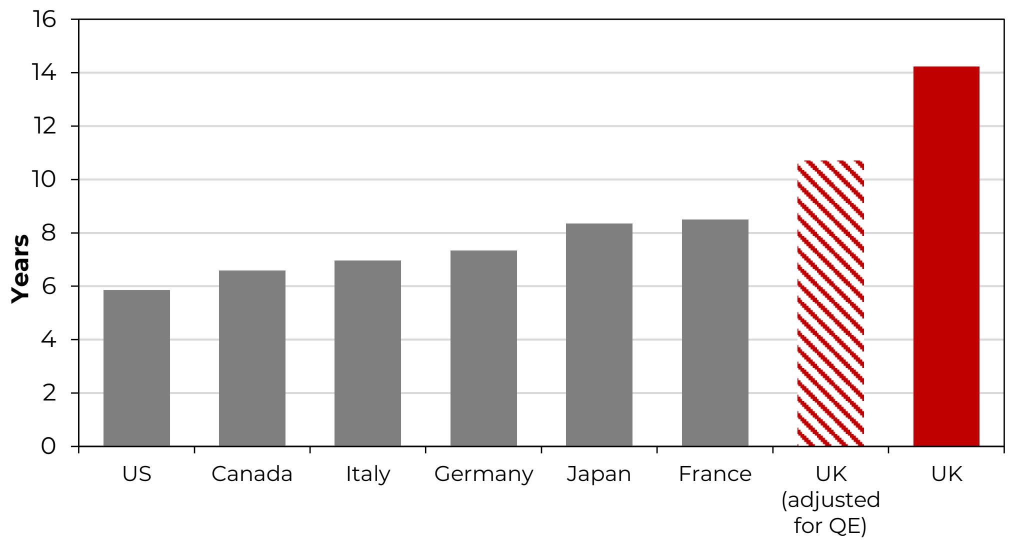
40. The Chief Secretary to the Treasury is running an ambitious public sector productivity programme across all government departments, to transform public service delivery and embrace the opportunities of technological change including artificial intelligence, whilst managing long-term spending pressures and continuing to deliver the outcomes and quality of public services the public expects. The government will continue to develop these plans ahead of the next Spending Review.

41. As well as ensuring debt as a share of the economy is on a sustainable path, the government makes decisions about how to borrow the money it needs in line with its debt management objective. This long-term objective is to minimise the cost of meeting the government's financing needs, taking into account risk, while ensuring that debt management policy is consistent with the aims of monetary policy. The government has taken action to address vulnerabilities in the structure of the UK debt position.

42. Changes to interest rates impact refinancing costs and debt servicing costs more slowly in the UK than in any other G7 country. The government has historically issued a high proportion of long-dated gilts. This has lowered annual refinancing needs, and reduced exposure to interest rates, all else equal. The FRS highlights a risk that the sensitivity of the consolidated public finances to rising interest rates has risen due to quantitative easing (QE) operations by the Bank of England. While this is true, the average maturity of the total stock of

gilts is significantly higher than other G7 countries. This remains true even after adjusting the UK figure for the impacts of QE and without applying any QE adjustment to other countries which will also face significant QE effects. This effect on maturity is now unwinding as QE unwinds which will increase the UK's effective debt maturity, all else equal.[28]

Chart 1: Mean maturity of the debt stock by country (November 2023)



Source: Bloomberg. QE adjusted figured based on HMT calculations using DMO and Bank of England data.

43. The FRS highlights the UK's relatively high share of index-linked debt and the risks this poses. There are benefits to issuing index-linked gilts which can generate savings for the taxpayer. Investors, especially pension funds, have been willing to pay a premium for inflation protection compared to nominal gilts.

44. As government borrowing is a long-term exercise, the cost-effectiveness of the borrowing programme should be assessed by looking over a long-term horizon. The value of issuing index-linked gilts over time can be assessed by comparing their associated interest and redemption payments to a simulated counterfactual scenario where the government had issued equivalent maturity conventional gilts instead. Using this method, analysis by the Debt Management Office

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[28] Calculated on a nominal weighted basis, excluding inflation uplift, including Treasury Bills. To adjust the UK's weighted average maturity of government debt outstanding for the impact of the asset purchase facility (APF), gilts held in the APF are treated as having a maturity of zero. By financing the purchase of fixed rated government bonds using floating overnight rate central bank liabilities, quantitative easing shortens the effective maturity of government debt outstanding. This effect is present across all countries where central banks have engaged in quantitative easing, including all G7 countries, but is only shown in the chart for the UK.

(DMO) shows that for gilts that matured since their introduction in 1981 but prior to August 2023 the government generated direct savings of around £77 billion in total from the issuance of index-linked gilts if valued at maturity, or £158 billion in 2023 terms.[29]

45. Nonetheless it is important to balance the cost benefits with the risks. In order to manage inflation risk, the government took action to reduce the proportion of index-linked gilts before the recent period of high inflation. In the five years prior to 2018-19, index-linked gilts accounted for around 25% of the government's annual debt issuance.[30] At Budget 2018, the government set out that it would "look to reduce index-linked gilt issuance in a measured fashion as a share of total issuance over the medium term", which it did.[31] Index-linked gilt issuance accounted for around 14% of annual gilt issuance on average over the last five years (up to and including 2022-23), which resulted in a fall in the proportion of the debt stock that is index-linked from 28.4% at the end of 2019 to 25.3% at the end of 2022.[32]

46. OECD analysis which takes into account the fact that returns on index-linked gilts change regularly in line with movements in inflation, as well as accounting for the impacts of QE, showed that the UK had a lower proportion of debt refixing at the 3-year horizon than Japan, Canada and the US.[33] This shows that, taken together, increases in interest rates and inflation feed through more slowly to debt interest and refinancing costs than in other countries.

47. Issuing index-linked gilts also underlines the government's stated commitment to low and stable inflation, reducing investors' perception of inflation risk and hence the yields they seek on nominal gilts.

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29 Each tranche of index-linked gilt (ILG) issuance was compared to a hypothetical conventional gilt of the same maturity raising the same amount of cash as the ILG issue. The cash-flows of each hypothetical conventional gilt were calculated by setting its coupon to be equal to the nominal par yield at the relevant maturity observed on a fitted curve of conventional gilt yields at the time the ILG tranche was issued. In order to make the different cash-flow structures of the conventional and index-linked bonds comparable, it was assumed that the cash-flows on each bond were financed until maturity at the zero-coupon rates that applied at the time of the cash flow. The gain/loss for each tranche of issuance was calculated by taking the difference between the value of all the cash-flows of the ILG and its hypothetical conventional equivalent as at maturity date. These gains/losses were also translated into present value terms by applying the zero-coupon rates from the maturity date of each tranche until August 2023.

30 Debt Management Report 2023-24, HM Treasury, March 2023

31 Budget 2018, HM Treasury, October 2018

32 Debt Management Report 2023-24, HM Treasury, March 2023

33 OECD Sovereign Borrowing Outlook 2023, OECD, May 2023

Fiscal Risk Register

48. In addition to the three key risks explored in the FRS, the government identifies and manages a wide range of risks through its fiscal risk management framework.[34] The OBR plays a vital role in supporting the government's risk management through its fiscal risk register. FRS 2023 provided an update on how that risk register has evolved since the last update in July 2021. This included consolidating the number of risks on the register from 87 risks to 53 risks on the restated risk register.

49. For the first time, the OBR has grouped the risks in its risk register based on the underlying source, categorising risks as 'shocks', 'policy risks' or 'long-run trends'.

Shocks

50. In common with other advanced economies, the UK has faced a series of global shocks in recent years. As the FRS highlights, economic and fiscal shocks have become more frequent and costly in the first part of this century. However, actions taken by the government to rebuild fiscal space by managing down the deficit meant that the government has been able to respond to each shock by supporting households and businesses where necessary and appropriate.

51. HM Treasury has well-developed frameworks to monitor and manage shocks, including the Economic Risk Group (ERG) and Fiscal Risk Group (FRG). ERG and FRG support risk management across HM Treasury by ensuring that interactions between risks to the macroeconomic outlook, financial systems, and public finances are systematically monitored and assessed in the round.

52. In addition, the government announced at Autumn Statement 2023 that it will provide up to £10 million funding over 2024-25 and 2025-26 to finance research on risks to the economy and public finances. This will include the understanding of risk impacts, their potential mitigations and response preparations.

53. The FRS highlights recent episodes of global financial sector stress. As recognised in the FRS, the government and regulators have made a number of reforms to the banking sector. These include increased capital and liquidity requirements, a bank resolution regime ensuring failing banks can be resolved in a stable orderly way, and a ring-fencing regime which requires major banks to separate their investment banking operations from their retail operations. The UK also has an extensive reform program for the non-bank sector, collaborating

[34] The government's response to the Fiscal Risks and Sustainability report 2022 outlines the government's five stages of fiscal risk management.

internationally with the Financial Stability Board to address vulnerabilities. The OBR acknowledged the success of these reforms in the FRS, stating that financial sector risk "did not crystallise despite the strains of the pandemic, reflecting the strengthening of capital requirements and other banking regulation since the 2008 financial crisis".

54. Underpinning all of this, the government has reformed the regulatory system, establishing the independent Financial Policy Committee with responsibility for addressing risks to the financial system, alongside the two powerful regulators – the PRA and FCA – to ensure the stability, safety and soundness of the financial system. As a result of this robust action to strengthen the resilience of the UK financial system, the Bank of England's Financial Policy Committee continues to judge that the UK banking system is resilient and has the ability to support households and businesses through a period of higher interest rates, even if economic and financial conditions turn out to be substantially worse than expected.

55. As highlighted in the FRS, cyber-attacks are in the second highest 'likelihood' category of the National Risk Register. The UK continues its work with global partners to detect and disrupt shared threats, and in 2022 the government launched a new National Cyber Strategy, outlining how it will build resilience for the public sector, people and business over the next decade.[35]

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[35] National Cyber Strategy, Cabinet Office, December 2021

Policy Risks

56. The fiscal policymaking process is set out in the Budget Responsibility and National Audit Act 2011 (BRNAA) and the Charter for Budget Responsibility. The Charter outlines the minimum requirements of the Budget Report, improving the transparency of the government's fiscal policymaking framework.

57. Addressing the question of fiscal policy announcements that are made outside of fiscal events, the Chief Secretary to the Treasury on 6 February 2023 stated in Parliament that there "may of course be extraordinary circumstances where that cannot be the case, as we saw during the pandemic, and it was right not to delay announcing critical help for households and businesses, but in normal times major fiscal announcements should be made with one of the OBR's two forecasts".[36] The government intends to apply the same principle to new major guarantee or insurance schemes, or major changes to the risk held in existing schemes.

58. Fiscal risks can also arise from local authority finances and the FRS notes the rise in prudential borrowing for financial yield that took place in the late 2010s. The government recognises that in a small number of local authorities high borrowing and investment has led to them facing excessive risk from their accumulated debts. Despite the scale of risk to the public finances being low, the government has taken actions to mitigate this. This has included clarifying the Public Works Loan Board (PWLB) lending guidance to address risks associated with lending to local authorities where there is a more than negligible risk of non-repayment and bringing forward the Levelling Up and Regeneration Act, which will expand the government's statutory powers to directly tackle excessive risk within the local government capital system. The government has also established the Office for Local Government to provide authoritative and accessible data and analysis on the performance of local government and support its improvement. The Department for Levelling Up, Housing and Communities continues to monitor the sector's finances and stand ready to speak to any council that has concerns about its ability to manage its finances.

59. The FRS also highlights increasing clinical negligence payouts as a significant fiscal risk, but rightly points to the consultation on a fixed recoverable costs scheme for lower damages clinical negligence claims, which is a positive step to manage rising clinical negligence costs. The government responded to that consultation in September 2023, setting out its position, and published a supplementary consultation focusing

[36] Hansard, UK Parliament, February 2023

on the specific issue of whether the cost of disbursements should be included within the fixed costs scheme.[37, 38]

60. An example of a policymaking framework success noted in the FRS is the steps the government has taken to increase fairness in the tax system to ensure that dividend income and capital gains are treated closer to employment income. The government has also reformed Research and Development (R&D) tax credits to reduce the scope for fraud and error in the regime and to ensure taxpayers' money is used as effectively as possible to support innovation. The government will continue to keep taxes and reliefs under review to ensure that they meet their policy objectives in a fair and fiscally sustainable way.

Long-run Trends

61. The final type of fiscal risk discussed by the OBR is those risks that materialise over a longer period. Some of these risks, such as health and social care spending, have already been discussed earlier in this response.

62. The FRS notes that these trends can "degrade the government balance sheet over decades". For example, when left unmanaged, contingent liabilities and other areas of uncertainty can become sources of fiscal risk. There has been continued improvement to the UK's balance sheet management capabilities related to contingent liabilities. The Contingent Liability Central Capability's report published alongside Autumn Statement 2023 enhances the government's transparency about these important liabilities. This allows the government to use the balance sheet in the future to take on risk to achieve policy objectives, where that is appropriate and good value for money.[39]

63. The government recognises the risks to global trade cooperation highlighted in the FRS. Since leaving the EU, the government has secured trade agreements with 73 non-EU countries (including the Comprehensive and Progressive Agreement for Trans-Pacific Partnership); total UK trade with these countries was worth £320 billion in 2022.[40]

64. Alongside this, the UK's relationship with the EU has markedly improved since the signing of the Windsor Framework in February, unlocking a set of further negotiations on the UK's European priorities. This has so far secured positive outcomes including on UK participation in EU R&D programmes (Horizon and Copernicus) and cooperation on

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37 Consultation response: fixed recoverable costs in lower damages clinical negligence claims, Department of Health and Social Care, September 2023

38 Open Consultation: Fixed recoverable costs in lower damages clinical negligence claims – a supplementary consultation on disbursements, Department of Health and Social Care, September 2023

39 Report on the UK Government's Contingent Liabilities, UK Government Investments, November 2023

40 UK Trade Agreements in Effect, Department for Business and Trade, November 2022

financial services (through the Financial Services Memorandum of Understanding). The implementation of the Windsor Framework is progressing well, as shown by the launch of the Green Lane for sanitary and phytosanitary movements from Great Britain to Northern Ireland in October 2023. The launch represents a significant and positive step towards the full green lane switch on in October 2024. The government also continues to pursue an ambitious programme of trade agreement negotiations to reduce barriers to trade and support UK prosperity – for instance with India, the Gulf Cooperation Council and Switzerland. Negotiating trade deals is key to mitigating the risk to public debt brought on by the threat of rising protectionism stemming from rising geopolitical tensions.

65. The government is committed to shaping an open global economy, ensuring a free trading system under which all countries are treated fairly, and standing up to economic coercion. The Integrated Review Refresh sets out how the government will pursue this agenda, using trade policy and diplomacy to update the institutional economic, financial and trade architecture and rulebooks to better manage systemic competition and to prepare for structural challenges.[41] The government will work ever more closely with allies, partners and low- and middle-income countries to build and maintain robust, reliable international relationships to uphold global norms, defend global rules and build global economic resilience.

66. As the UK transitions to net zero, the government will need to ensure that the tax system encourages the uptake of electric vehicles, and revenue from motoring taxes will need to keep pace with this change. At Autumn Statement 2022, the Chancellor announced that, from April 2025, electric cars, vans and motorcycles will begin to pay Vehicle Excise Duty in the same way as petrol and diesel vehicles.

67. Finally, the government notes the OBR has assessed a decreased likelihood of a narrowing of income and capital tax bases crystalising into a fiscal risk. This results from steps taken by the government to make the tax system fairer and more efficient. The individual allowances for investment income in the UK are some of the highest in world, and the government has taken steps to broaden the dividend and capital gains tax base to ensure fairness in the tax system relative to employment income.

[41] Integrated Review Refresh 2023, Cabinet Office, March 2023

Conclusion

68. The UK has been hit by a succession of global shocks since the start of this decade. The government's careful management of the public finances has allowed it to provide necessary support to households, businesses and the economy.

69. As set out in this response, the government has taken decisive action to mitigate risks, including those identified by the OBR. This includes announcing an ambitious set of policies to bring more people back to work, setting clear plans to achieve net zero whilst minimising the burden for consumers and families and taking fiscally responsible decisions to place the public finances on a sustainable footing.

70. Autumn Statement 2023 ensures debt continues to fall as a share of GDP in the medium term and borrowing is lower on average across the forecast. The OBR has confirmed the government is on track to meet its borrowing and debt fiscal rules.

71. The government welcomes the OBR's FRS which plays an important role in assessing risks to the public finances, and sits alongside the government's effective fiscal risk management framework.

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