Tony Travers November 1st, 2024

Meat on the bone or scraps from the table? What the budget tells us about Labour’s vision for government

***Professor Tony Travers** reflects on Chancellor Rachel Reeves’ first budget and whether it can provide drive and direction for a Government looking to improve on a lackluster start.*

This week’s Budget was a carefully staged ‘big event’ where the newish government set out the thinking behind its approach to government and its proposed solutions to a range of economic challenges facing the UK. Because so many weeks had passed since the general election on 4 July, expectations had risen to fever pitch, with relentless media speculation about different tax rises and spending priorities. The outcome was curiously radical, with major tax rises and a short-term boost to public expenditure. It was, without question, a very Labour political statement.

Successive British governments have attempted to offer the electorate Sweden’s public services with American tax levels: promising a large and growing cradle-to-grave welfare system, but with taxes lower than those paid in France or Germany. This implausible proposition has been more-or-less delivered in recent years by a mixture of relentlessly squeezed public services and a regular resort to public sector borrowing. Before 2008, economic growth also helped sustain the fiction that spending can go up while taxes are held down.

Eventually, a tipping point has been reached. In January this year, Richard Hughes, chairman of the Office for Budget Responsibility, described the previous government’s public spending plans for future years as “worse than a work of fiction” and noted that ministers had not been transparent about the inevitable scale of future public sector cuts in the years after 2024-25. We now know, following the general election, that many public services are close to breaking point, with virtually no spare prison places available, long NHS waiting lists, defence under-funded and many councils close to a financial cliff-edge.

Moreover, since the 2008 banking crisis, average UK economic growth has fallen well below its previous long-term trend of 2½ to 3 per cent. Taxation is high by post-1945 standards while a succession of international crises, eg the pandemic and Russia's invasion of Ukraine, have pushed public sector borrowing and debt to levels where they cannot easily rise much further.

Chancellor Rachel Reeves delivered her Budget against this challenging backdrop. She chose to raise taxation by £40 billion, to change the rules to allow her to borrow more to increase public investment, and to make symbolic cuts to public expenditure. Public spending will be £70 billion higher and government borrowing up £30 billion. The scale of these changes, against the backdrop of GDP growth of two per cent in 2025 (and 1.8 per cent in 2026) was, as Sir Humphrey Appleby might have said, 'brave'.

The big winner in terms pf public expenditure was the NHS. Health and social care spending will rise by £22 billion between 2023-24 and 2025-26, an average of 3.4 per cent per year in real terms. This jump is the more remarkable given that UK public sector health spending was 33 per cent higher in real terms in 2023-24 than in 2010-11. Similarly, the welfare budget, largely because of the triple-locked State pension, has risen by 16 per cent in real terms since 2010.

According to the Office for Budget Responsibility, so-called 'unprotected' services such as justice, transport and local government will be given modest real terms increases in spending in 2025-26, but then face cuts thereafter. Schools are expected by the OBR to see flat real terms funding per pupil. Universities' funding (apart from a brief mention of research) was not mentioned in the Budget book or the OBR's economic and fiscal outlook.

The single biggest tax rise affected employers' national insurance contributions, which will raise over half of the extra £40 billion to be collected. The public sector will be compensated for the costs of this change, but it appears private sector institutions such as care homes and universities will have to pay. OBR assumptions appear to suggest undergraduate fees will rise in line with inflation from 2025-26.

The government made every effort, as did its predecessor, to avoid increasing direct taxes on individuals. Business bore the brunt of the tax rises, begging questions about the final incidence of employers' national insurance. The Resolution Foundation concluded the higher NIC contributions will feed through into lower wages and higher prices. Thus, employees will be affected, though in indirect ways.

The political impact of UK Budgets is hard to judge in the immediate aftermath of the event. It will take some weeks for the full effects to be understood and even longer for economic consequences to be measured. Much of the early press reaction was neutral to negative, while the bond markets pushed up the yield on 10-year gilts. The pound fell slightly. Again, it will take days or weeks fully to reveal market and investor sentiment.

Labour inherited public finances in a weak condition. A mixture of past decisions (not only by the previous government) and global events mean the 2024 UK general election was not a great one to win. The government's poll ratings are already grim, reflecting both the economic challenge they face but also their relatively low vote share in July's election. Winning 63 per cent of the seats in Parliament with 34 per cent of the vote was arguably a 'too strong yet too weak' starting point for them. Mid-term unpopularity has arrived in just over 100 days.

The electorate's judgement on the Budget will be revealed in opinion polls. It would be surprising if there were a sudden popularity 'bounce', but doubtless Sir Keir Starmer and his Chancellor feel they are playing a longer game, hoping economic growth will allow tax cuts and/or higher public spending in three to four years' time in the run-up to the next election. To add to the pressures bearing down on the government, the Conservatives will very soon be refreshed by having a new leader, while the US presidential election could dramatically affect the UK's economic prospects. Government is not easy.

Note: this article gives the views of the authors, and not the position of the LSE Department of Government, nor of the London School of Economics.

Image credit: HM Treasury

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