CENTRE FOR POLICY STUDIES
Est. 1974

Budget Briefing: The Age of the Super-State

- Just three years ago, the Centre for Policy Studies warned that Britain was set to enter the age of the trillion-pound state, with public spending passing the £1 trillion mark for the first time.

- In the wake of the Budget, we are now set for the state to spend an astonishing £1.5 trillion by 2029/30 – a huge rise on an already gargantuan figure.

- Both taxes and spending will rise to, and remain at, historic highs. In fact, the tax burden will reach its highest sustained level for more than 300 years – more even than during the World Wars.

- Despite claiming to prioritise growth, Labour is instead choking it off. In the absence of gangbuster growth from the Government's planning reforms, the Office for Budget Responsibility (OBR) predicts another five years of mediocre growth and squeezed living standards. The idea that Britain will become the most dynamic economy in the G7 already looks like a laughable fantasy – in fact, on current forecasts we will struggle to reach the G7 average.

- In particular, the huge tax rises on business will have a chilling effect on the private sector. The OBR projects that the measures – especially the huge increase in employer National Insurance Contributions – will reduce business investment, trade and private sector consumption by a combined 1.5% of GDP. The hospitality sector, small businesses, farming and family businesses will be particularly badly hit.

- The structure of the Budget also means that there is a real risk of either further tax rises or even a debt crisis if growth does not materialise, in particular at the pinch point in the third year of the forecast. The massive increase in borrowing also leaves the public finances extremely vulnerable to further inflation and interest rate shocks.

- It is also deeply uncertain whether the Government's extra spending will deliver the promised benefits. While the NHS will receive a substantial boost, the taps will be turned off relatively quickly. Meanwhile, the effectiveness of Labour's plans to borrow to invest remains dependent on the state's ability to pick the right investments – something on which we remain extremely sceptical.

- In short, this is a Budget which prioritises the public sector over the private – with concomitant effects on growth.

CENTRE FOR POLICY STUDIES
Est. 1974

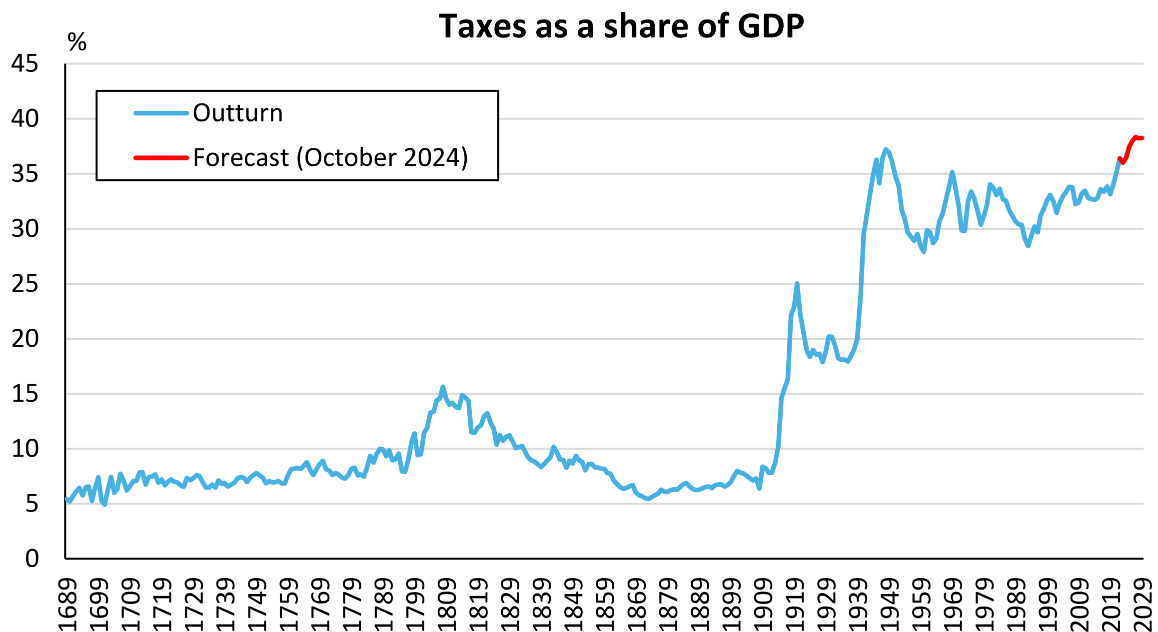
The Big Picture: Stagnation Follows Stagnation

- Before the election, Labour pledged that it would boost Britain's economic growth to the highest sustained rate in the G7**. Based on the latest IMF forecasts, that would entail average annual GDP growth of at least 2.2%.**

- The OBR is now projecting that UK GDP growth will average a meagre 1.6% between 2024 and 2029 period. **This would not even reach the average of the G7 nations, let alone top the table.**

- This is also poor by historical standards. UK economic growth averaged around 2.5% before the financial crisis and 2.0% during the 2010s. So **these latest figures represent a dire outlook** – not least since, as previous CPS analysis has shown, we need growth to average 2.9% over the next 50 years just to cope with the fiscal pressures of an ageing population, let alone meet other aspirations like increasing defence spending.[1]

- Before the election, Labour promised it would not need tax rises because it would deliver growth. **In fact, Labour are already attempting to meet fiscal pressures through record levels of taxation – the highest in at least 300 years.**



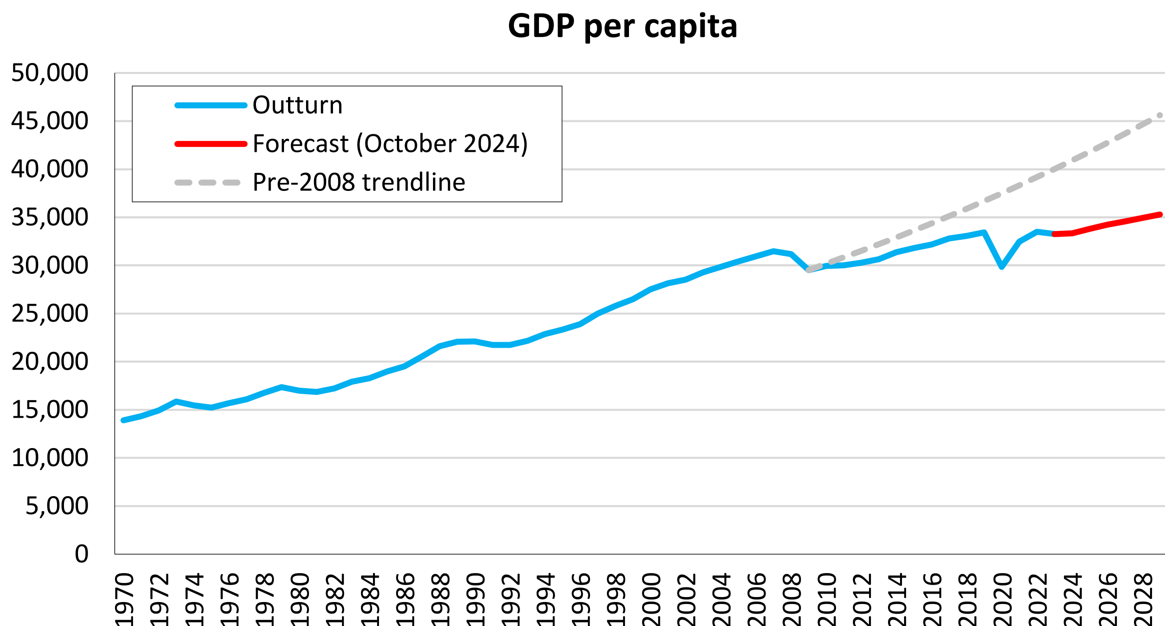
Sources: OBR, BoE

[1] K. Williams, 'The Age Trap', in M. Feeney & R. Colvile (eds.), *Justice for the Young*, CPS (2023). Link

- The OBR now projects taxes as a share of GDP to climb to 38.2% by 2029 (compared to 37.1% by 2029 in the March 2024 forecast). **This is the highest level in modern times, surpassing the previous record of 37.2% in 1948.** But if we look at Bank of England data going back to the Glorious Revolution of 1688/89,[2] taxes as a share of GDP have never been as high as the OBR now projects them to be in a few years' time – not least since we paid for the World Wars primarily via borrowing rather than taxes.

- Admittedly, the OBR has yet to score the Chancellor's wider growth plans, for example on housing. But **the policy measures announced in the Budget have not just failed to boost growth rates, but will actively undermine them**. The OBR says the Budget will reduce business investment, trade and private sector consumption, projecting the share of GDP accounted for by these activities to be down by a combined 1.5 percentage points by 2029-30. In effect, Labour has already given up on economic growth led by the private sector.

- As a result, **we face another decade of virtual stagnation in living standards**. The OBR projects per capita GDP growth of just 1.0% over 2024-29. By 2029, GDP per head will only be 5.5% higher than in 2019, and barely 12% higher than in 2007. We are set to be almost £10,000 per head poorer than if GDP per capita growth had recovered to the pre-2008 trend.



Sources: OBR, ONS

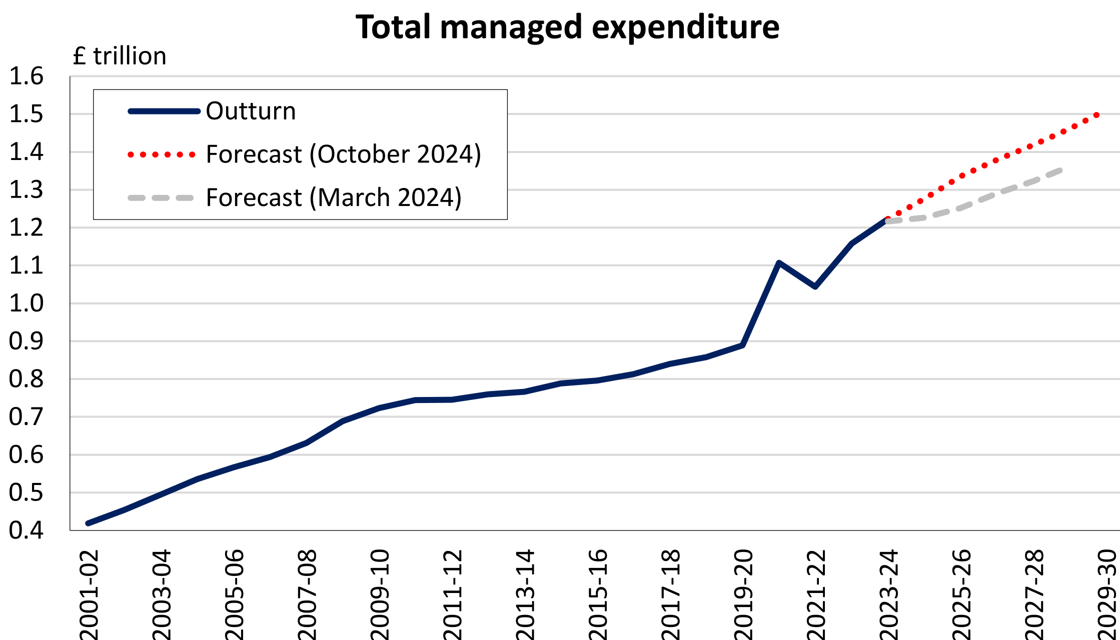
---

[2] Bank of England, 'A27. Central govt borrowing', *A millennium of macroeconomic data for the UK: The Bank of England's collection of historical macroeconomic and financial statistics* (2017). Link.

- But **even this per capita growth rate looks worryingly unrealistic**, based as it is on underlying productivity growth of 1.0% a year – versus 0.6% in the 2010s**.** There is no sign that productivity has revived from historic lows, least of all in the public sector. And while more public sector capital investment might eventually boost productivity, the OBR points out that 'Government investment takes longer to affect potential output than business investment'.[3] In the meantime business investment has been significantly crowded out.

- It is certainly true that Rachel Reeves is faced by challenging fiscal headwinds, not least an ageing population, geopolitical uncertainty and the baleful legacy of the Covid pandemic. But aside from a welcome commitment to a 2% efficiency and productivity target for all government departments, there is little sense that Labour is willing to grasp these issues – notably working-age economic inactivity – or indeed to think creatively about reforming the tax system or how public money is spent. **Instead, the Budget showed Labour reverting to its high-tax, high-spend instincts, redistributing money from the private to the public sector.**

- Just three years ago, the Centre for Policy Studies warned that Britain was set to enter the age of the trillion-pound state, with public spending passing the £1 trillion mark for the first time. In the wake of the Budget, we are now set for the state to hit £1.5 trillion by 2029/30, equating to 44.5% of GDP. **As the graph below indicates, while previous governments managed to 'flatten the curve' between 2010 and 2020, since Covid the trajectory of state spending has rocketed. This is unsustainable.**



Source: OBR

[3] OBR, 'Economic and fiscal outlook – October 2024' (October 2024), pp.8, 30. Link.

- There was also, on top of the rises in tax, a substantial increase in borrowing – accompanied by the 10th set of fiscal rules since 1997. The big problem for the Government, however, is that **most of its increases in public spending are front-loaded.** Will the Labour leadership be able to resist future pressure to further increase spending, and hence borrowing?

- As things stand, public sector net financial liabilities (PSNFL) are projected to be 83.4% of GDP by 2029/30, down only marginally from a peak of 84.2%, while public sector net debt excluding Bank of England liabilities (PSND ex-BoE) is projected to rise to 95.8% of GDP – the highest level since the early 1960s. **A debt crisis before 2029 is a real possibility, especially if economic growth remains low and interest rates surge again.**

- In particular, **the third year of the forecast, 2027/28, could be a real crunch point**. The increase is public spending is supposed to have levelled off, fiscal rules will be imposing 'iron discipline' and headroom will be very limited, while the freeze on income tax thresholds also stops. Unless greater growth has materialised, things could get very tricky for Labour.

Taxes on Jobs and Investment

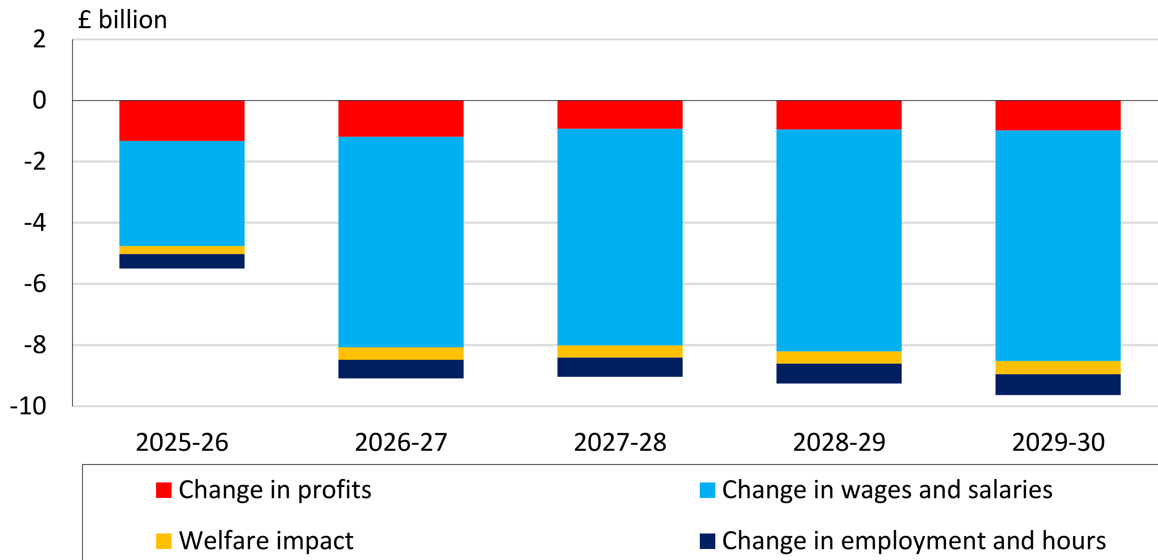
The tax rises in the Budget are the most significant in the last 50 years, eclipsed only by Norman Lamont in the wake of Black Wednesday. Despite Labour's verbal contortions, the impact of the increase in employers' National Insurance will very clearly fall on working people, especially those on lower pay, while other tax rises will also damage investment, business and wealth creation.

- Purely in terms of the magnitude of the tax rises, this Budget has been one of the most significant of the last 50 years, with taxes as a share of GDP rising by 1.25%.[4] Only Norman Lamont's 1993 Budget in the wake of Black Wednesday exceeded this. However, Rachel Reeves' Budget is arguably even more significant, in that her measures penalise business investment and job creation when we desperately need firmer economic growth. **Her National Insurance increase alone would make this the seventh largest tax-raising Budget in recent decades**.

- The largest change is the increase in the rate of employers' National Insurance, from 13.8% to 15%, and lowering the threshold at which employers start paying NI from £9,100 to £5,000 per year. If no employers changed their behaviour, this would raise £26.4 billion in 2029-30. But after accounting for behavioural changes, the OBR predicts that it will raise £16.1 billion. As per the graph on the next page, **the difference – £10 billion – is due to behavioural changes among businesses and workers.**

[4] R. Colvile, 'Budgets since 1970, by magnitude of tax rises:', *X* (20 October 2024). Link.

Costing of behavioural changes due to rise in employer NICs



Source: OBR

- Crucially, **the OBR expects the vast majority of this tax increase to fall on workers via lower wages and higher prices**. While the tax incidence on workers starts at 60% at the start of the forecast period, by the end it is 76%, with the remaining 24% falling on profits. The OBR also projects the increase in employers' NI to feed through into a 0.2pp reduction in the size of the workforce, with more people choosing to remain economically inactive.

- When combining this with changes to minimum wage rates, the cost of employment to business will increase substantially. For a business employing a minimum wage worker on 35 hours per week that cannot make use of remaining exemptions, annual costs will now increase by around £2,300. **The change in the NI threshold also means that Labour's NI revenue raising efforts will fall disproportionately on the lowest earners.** This could also raise barriers to people moving from welfare back into work by introducing very high marginal rates at the intersection of the tax and benefits systems.

- **Capital gains tax is also rising.** The main rates of CGT will be aligned with residential property, with a lower rate of 18% and a higher rate of 24% (an increase from 10% and 20%). From April 2025, business asset disposal relief and investor's relief will rise from 10% to 14%. After accounting for behavioural responses, equivalent to £4 billion, these changes raise £2.5 billion by 2029/30. These responses, in the OBR's words, reflect taxpayers 'deferring asset disposals ('locking in'), minimising chargeable liabilities by restructuring their affairs, or shifting some gains into income in light of the reduced wedge between tax rates'.[5] While not as damaging to Britain's competitiveness as the larger increases trailed ahead of the Budget,[6] this increase is still damaging, especially in the context of other measures announced.

---

[5] OBR, 'Economic and fiscal outlook – October 2024' (October 2024), p.56. Link.
[6] D. Herring, 'The UK's International Tax Competitiveness: 2024 Update', CPS (2024). Link

- Inheritance tax receipts are due to rise, by reducing agricultural and business property reliefs, and extending its application to pension wealth. **This will be a disaster for family businesses, especially in rural areas.** This raises £2.3 billion, although the report notes that much of the increase in tax on pension wealth will be lost as people will look to spend it before death. The Government is also raising the higher rate of stamp duty for additional dwellings to £0.4 billion.

- The effect of both of these changes is that taxes on capital (IHT, CGT, stamp duties) are set to rise from 1.4% of GDP in 2023/24 to 2.2% in 2029-30.[7] **This is deeply troubling, as these are the taxes that are most damaging to economic growth, distorting and deterring investment**.

- It is also worth noting that a range of economists and think tanks on both left and right (including the CPS) had argued that a straight rise in CGT would be damaging, and that the entire tax needed reform. More widely, **there was depressingly little sign of creative thinking about the tax system, or pro-growth reform**: the Chancellor instead focused almost exclusively on closing 'loopholes' or raising rates.

- The Government has also completely abolished the non-domicile regime and increased the carried interest thresholds. **By 2029/30 the changes to the non-domicile regime will raise just £100 million in additional tax. This is largely through non-doms being caught up in inheritance tax – the OBR forecasts that the Government will lose money on foreign income and gains.**

- Given the huge hit to living standards in recent years, it is sensible for the Chancellor to maintain the freeze and 5p reduction on fuel duty. However, **declining fuel duty revenues also underline the need for longer-term thinking about how we charge for road use** (particularly with Labour keen to accelerate the transition to electric vehicles) – as the CPS has repeatedly pointed out.[8] As elsewhere, this Budget was a missed opportunity for creative tax reform.

Favouring the Public Sector over the Private Sector, and Central Planning over Markets

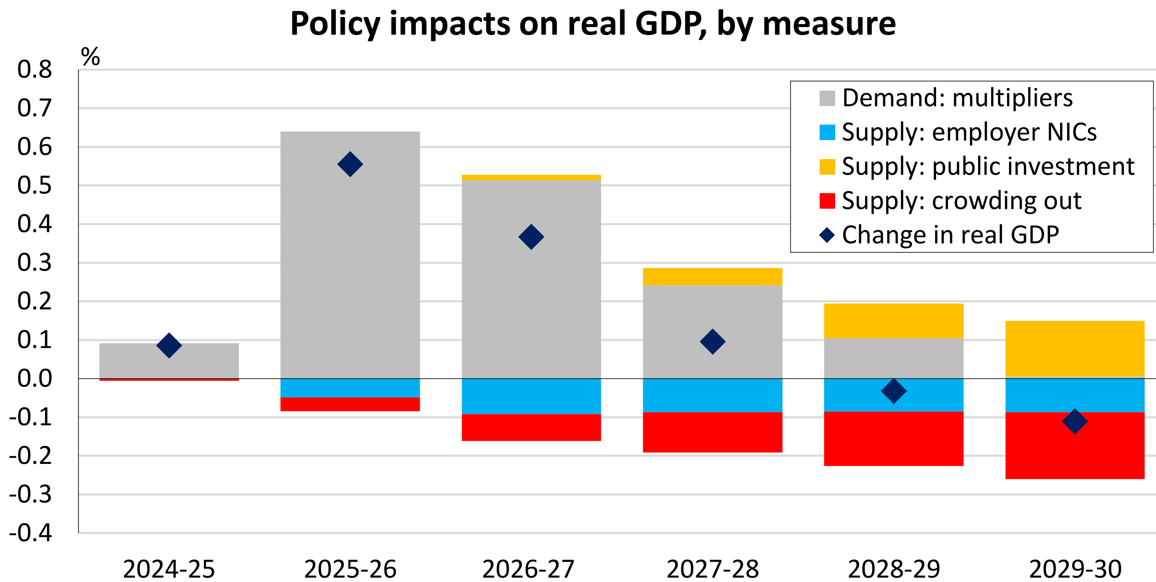
The Budget tilted the balance further towards the public sector, and away from the private.

- As is traditional, the Labour Party's recipe for growing the economy relies on the state doing the heavy lifting. Predictably, the OBR reports that **the economic boost from higher government spending will fade by the end of the five-year forecast period**, and given the negative impact of both the NIC rise and crowding out of business investment – equivalent to 0.17% of GDP after five years – the overall effect of the Budget turns negative before 2030.

---

[7] OBR, 'Economic and fiscal outlook – October 2024' (October 2024), pp.88. Link.
[8] See for example: D. Smith & T. Clougherty, 'The Future of Driving', CPS (2023). Link

- Things look better in the 2030s, as the effects of higher public sector investment feed through. But **the damage to business investment means the overall value of this lopsided approach to investment is dubious at best**.



Source: OBR

- This is because growth from greater public sector investment relies on its effect on private investment. The OBR uses a figure of a £0.30 increase in business investment for every £1 of public investment, but points out that this is highly uncertain, with estimates ranging from an increase of £2 to a reduction of £0.30.[9] One of the many factors that influence this is the type of investment. For example, a new train line will likely have quite different effects on private investment than a new public housing development. Applying this range of estimates produces substantial variations in the model's output – **meaning Labour is taking a gamble that the state will be better at allocating investment than markets.**

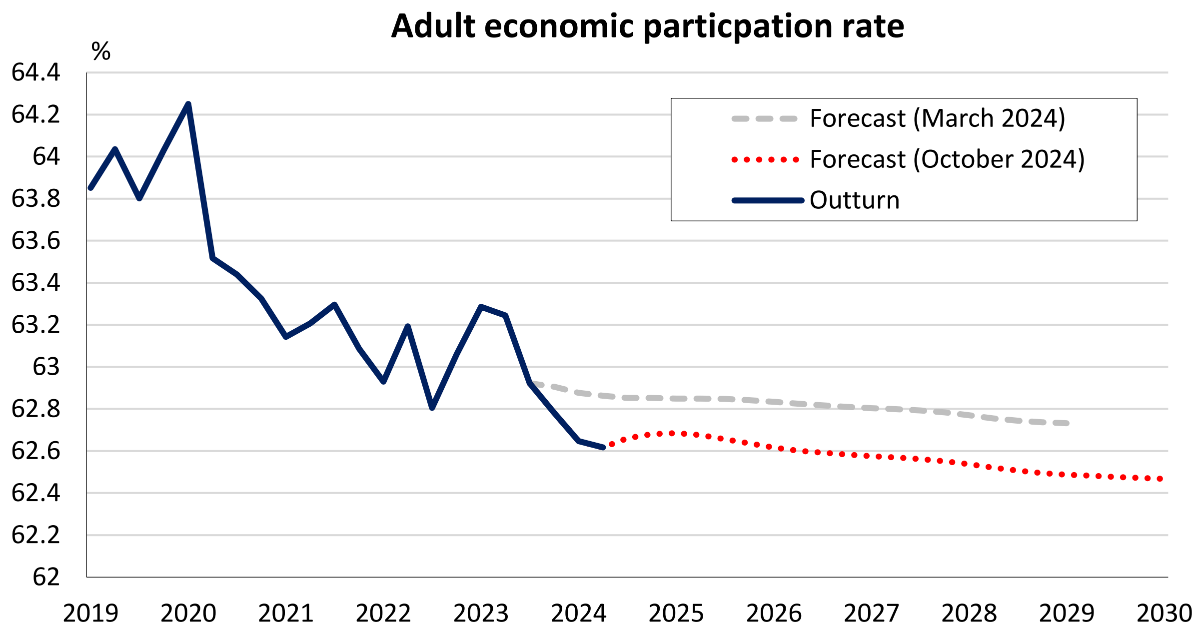
More Welfare, Less Work

Despite talk of a focus on economic inactivity and welfare reform, there was very little in the Budget to encourage people back into work, and a great deal to discourage it.

- As noted above, under this Budget, the state will continue to grow. **The share of GDP accounted for by public sector spending is projected to stand at 44.5% by 2029** – 4.9pp higher than before Covid, and 2.1pp higher than projected in the March 2024 Budget.

[9] OBR, 'Economic and fiscal outlook – October 2024' (October 2024), pp.82. Link.

- A major explanation is the rising welfare bill – and not just for pensioners. **Annual non-pensioner welfare spending is projected to rise by 26% or £40.3 billion – roughly equivalent to all the revenue raised by the Chancellor's tax rises.** Spending on health and disability benefits is expected to rise from £64.7 billion to £100.7 billion in 2029/30, or 2.9% of GDP. Spending on working age adults is three-quarters of this figure, but it is also worth noting that disability benefit spending on children is set to almost double to £7.2 billion.



Source: OBR

- **The Budget had a disappointing lack of focus on the problem of working-age economic inactivity – and in fact moves things in the wrong direction.** The economic participation rate is projected to fall to 62.5% over the forecast period, pushing any return to pre-Covid rates of economic activity back even further – over 0.2pp lower than in the March 2024 budget. According to the OBR, Labour's tax changes account for 0.1pp of this – roughly 52,000 fewer people in work.

- The Chancellor also announced a 4.1% increase to the state pension as part of the Government's commitment to the pensions triple lock. This means that the basic state pension will increase to £176.45 a week in April 2025 and the new state pension will go up to £230.30 a week. While this measure will provide relief, especially for those pensioners affected by the restriction of winter fuel payments, it further solidifies the problem of growing pensioner spending as the working age population shrinking in relative terms. **Pensioner spending is expected to increase by £40 billion over five years, to £182.7 billion, or 5.3% of GDP.**

CENTRE FOR POLICY STUDIES
Est. 1974

A Health Service with a Nuclear Deterrent

The NHS received the bulk of the extra money raised by the Chancellor, to the point where the health budget is now roughly equivalent to the entire GDP of countries such as New Zealand or Greece.

- The single biggest item on the Chancellor's list of public spending increases was, inevitably, the NHS. She announced an increase of £22.6 billion in day-to-day spending and £3.1 billion in additional capital spending by 2025/26 – **entirely swallowing up the additional employers' NI revenue and then some**.

- As a result, **by 2025/26 the NHS will make up almost 17% of day-to-day government spending** (£192 billion, rising to £200 billion including social care), and 10% of capital spending. Total health and social care spending will account for 16% of the total government current and capital spending by 2025/26.

- This increased NHS funding is supposed to expand capacity and upgrade buildings, but we shall have to wait until the spring to hear Wes Streeting's plans for how to translate additional funding into higher productivity. It is worth highlighting that **despite NHS funding having increased by over £70 billion in since 2016, productivity has stagnated** – and previous CPS research has found a negative correlation between NHS spending and productivity increases.[10]

- In 2025/26, total annual spending of just over £200 billion on the NHS would be roughly equivalent to the current GDP of New Zealand or Greece (according to IMF data),[11] up from current levels of around Qatar's GDP. **The old jest about the UK becoming a health service with a nuclear deterrent attached becomes truer with each passing year**.

An Innovation Nation?

The Chancellor displayed a welcome focus on supporting innovation, but kept to the recent Conservative approach of picking winners from on high.

- The Chancellor committed in the Budget to 'keeping current rates of research and development relief to drive innovation', which is welcome. **She also announced investments targeted at specific sectors, with a focus on advanced manufacturing and the industries of the future.**

- However, this sort of industrial strategy strays perilously close to the 'picking winners' approach of the post-war period. Furthermore, the amounts involved – £1 billion for aerospace R&D, for example – are trivial compared to what the US or China are spending to subside strategic industries. **If we are to compete for investment, it needs to be on the basis of business-friendly rules and regulations and a competitive tax system, not subsidies allocated by committee.**

---

[10] CPS, 'Why the health of the NHS depends on growth and reform', May 2018. Link.
[11] IMF, 'GDP, current prices', WEO (October 2024). Link.

- Plans to use technology to boost public sector productivity are welcome, but familiar. **Public sector productivity has remained remarkably stubborn amid a wide range of technological advances**, only inching up since the 2010s before Covid took us right back to the start. No doubt technology can help, but the answer to public sector productivity is not investments in technology, but a fundamental reassessment of the role, goals and management of the public sector**.**

Family Unfriendly

The Budget continued the recent approach of neglecting the interests of the family in the tax system, and stoking demand for childcare rather than properly reforming the market.

- In March 2024, the last Government announced plans to move the assessment of the high income child benefit charge (HICBC) from an individual basis to a household basis. This would – as the CPS argued in its paper 'Family-Friendly Taxation' – have removed a major distortion in the tax and benefits system, and made things fair for families.[12] However, Rachel Reeves has now scrapped these plans. This means that a dual-income household earning £115,000 (where both earners earn less than £60,000) could get full child benefit, while a single-income household earning far less overall would be ineligible. **This will penalise single-parent and single-earner households**.

- An additional £1.8 billion has been announced to continue the expansion of government-funded childcare in order to 'help more parents, particularly women, stay in and return to work'. There are three problems with this. First, it does not address the root cause of high childcare costs – which as previous CPS work has shown are driven up by a number of government-imposed subsidies and regulations. Second, it does not take into consideration the wishes of many parents to look after their children themselves. Finally, as noted by the OBR, 'there is a risk of a shortfall in the supply of funded places and staff for the September 2025 expansion, which will be the largest one yet'. **As has been the tendency for years now, the state is stoking demand while not addressing the fundamental problems with supply of childcare.**

---

[12] R. Jayawardena & T. Clougherty, 'Family-Friendly Taxation: How to restore fairness to the tax system', CPS (July 2023). Link.

CENTRE FOR POLICY STUDIES
Est. 1974

Living Standards Squeezed, Again

The OBR predicts more cost of living pressures, not least due to businesses passing on the costs of tax rises. Meanwhile, higher employment costs will hit young people and low earners.

- Real household disposable income per capita is expected to grow by an average of just 0.5% per annum between 2024/25 and 2029/30. This is largely owing to wage settlement expectations holding up relative to inflation in the near term, but **growth in household disposable income per capita is then set to stagnate in 2026/27 and 2027/28**, before making a weak recovery at the end of the decade. The stagnation is partly due to weaker projected growth and partly due to businesses rebuilding their profit margins and passing on the costs of increased NICs via slower wage growth.

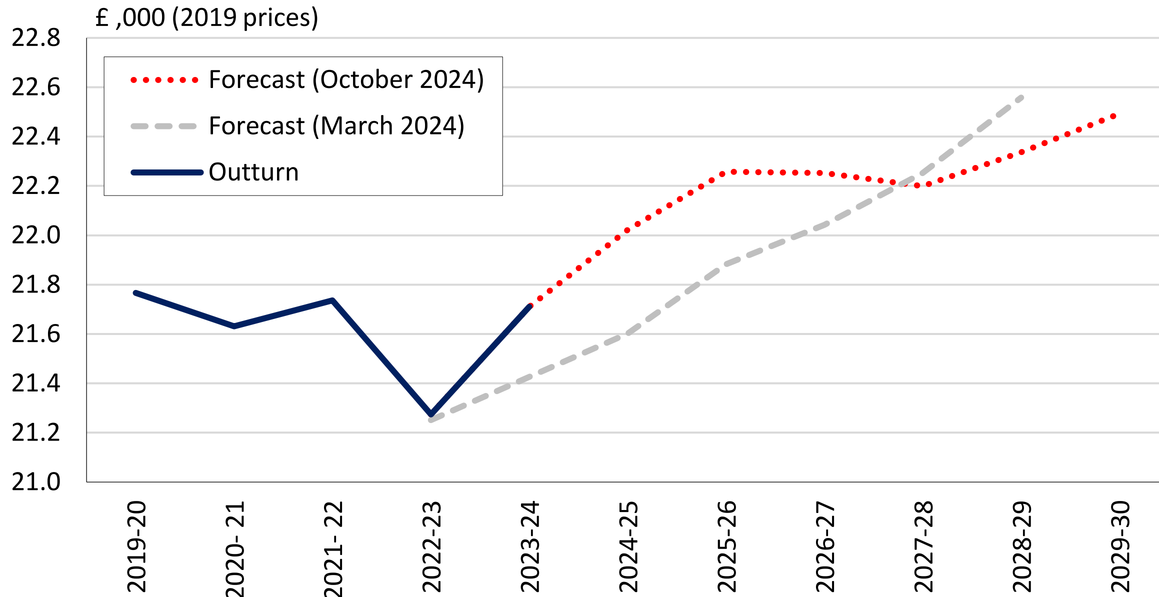
- The Chancellor's decision to raise the national minimum wage for those aged 21+ by 6.7% will result in **an increase of £1,400 a year for an eligible full-time worker, but it will also distort the labour market and create higher labour costs**. While research suggests there is little evidence of adverse employment effects before minimum wages reach around two-thirds of median wages, the risk grows after that point.[13]

- The national minimum wage already reached 67% of median earnings in 2024. **It is entirely possible that the further increase in national minimum wage will lead to more unemployment,** especially for low-skilled workers – not least when combined with the increase in employers' NICs and the lowering of the threshold to encompass lower-paid or part-time workers.[14]

- The stated ambition to move towards a flat minimum wage for adults of all ages by increasing the minimum wage for younger workers and apprentices at faster rates is likely to harm the job prospects of younger and therefore less experienced workers in particular. **Rather than fixing prices in the Labour market, the Government should be making it easier for investors, entrepreneurs and employers to create new jobs.**

[13] A. Dube, 'Impacts of minimum wages: review of the international evidence', HMT (November 2019). Link.
[14] See also: T. Leunig, 'The UK Minimum Wage', *Tim Leunig's Policy Substack* (21 October 2024). Link.

Real household disposable income per person



Source: OBR

Eroding Energy Security

Labour appears entirely happy to kill off the North Sea, but it is Britain's energy security that will suffer.

- The widely trailed increase in the Energy Profits Levy to 38% (taking the headline rate of corporation tax in the North Sea to 78%) and its extension by a year are unwelcome. But **the true hammer blow is the removal of the North Sea capital investment allowance for most new offshore projects.** Coupled with Labour's crusade against new exploration licences and the uncertainty created by judicial activism, the climate for investment in oil and gas assets has been meaningfully weakened. The OBR now expects North Sea investment to be 26% lower by the end of the forecast period, with operators' oil production 6% lower and gas production 9% lower on average compared to its March 2024 forecast. That means fewer jobs in Britain, and greater reliance on oil and gas imported from often unsavoury regimes.

- On a more positive note, while the hydrogen and CCUS project funding announced by Rachel Reeves had already in fact been announced under the last Government, it is nevertheless welcome that Labour has confirmed its commitment to these long-term decarbonisation projects, and is at least making the right noises about crowding in private sector investment.

CENTRE FOR POLICY STUDIES
Est. 1974

Housing to the Rescue?

Labour have made the right noises on housing and planning, but as elsewhere they are too focused on the public sector and not enough on the private – including effectively killing off Right to Buy.

- If Labour could pull one lever to get growth going again, then it should be housebuilding and planning reform. Indeed, **Rachel Reeves's main hope for growth is that the Government's planning reforms – not costed by the OBR – feed into higher than expected growth**, given that the growth expected is pretty anaemic.

- Before the election campaign, Labour made the right noises on this, but have yet to deliver. For example, MHCLG's resources will increase only slightly, rising from £12.3bn, rising to £12.6bn in 2025-26.

- Curiously, the various proposed increases in expenditure come to at least £900 million. This means that at least £600 million of cuts are being made elsewhere in MHCLG – seemingly to levelling up funds, though the OBR is non-specific, alluding cryptically to the Government's being 'minded' to cancel local enterprise partnerships and levelling up funding. **The Government needs to be up-front about this, specifying what it is cutting in as much detail as it specifies what it is funding**. The question is not merely whether more money for social and affordable housing is a good thing, but whether it is better than what it replaces.

- Some £500 million has been earmarked for an increase in the Affordable Homes Programme, which funds social housing. MHCLG says this will deliver 'up to 5,000 new homes'. But this depends on what the homes are, and where they are built. **An average subsidy of £100,000 per home would be significantly higher than the current level, but substantially less than the £160,000 grant per affordable home in London**. Generally, it will be more expensive to build homes in the areas of highest demand – and given high build costs, the Government is still relying on others to provide the rest of the money for each home.

- Moreover, since these additional homes would contribute towards housing targets, and since councils have little reason to allocate more land than necessary for meeting those targets, **these additional social homes might effectively cannibalise market housing.** This would mean that the net increase in homes achieved by this expenditure could be lower still.

- The announcement of £50 million to increase planning capacity was welcome announcement – but is not very much when split between 330 planning authorities. The Government has also announced £3bn of guarantees for housing developers. But ultimately, the housing crisis is caused by a lack of supply. **To get Britain building, the Government needs to stop banning housing**, not add even more demand for it.

- Labour's continuing ideological opposition to allowing social tenants the chance to own their homes was once again on display, with a reduction in the discount for the Right to Buy by around two thirds. Based on past trends, this will cut uptake to approximately zero. **The announcement should thus be seen as the de facto death of the Right to Buy.**