Prospects

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UNITED KINGDOM – 2024 General Elections

Labour hovering between ambitions and reality

- **The British will be heading out on 4 July to vote in early general elections. Polls predict a victor for Labour that could see the party take a large majority in the House of Commons.**
- **Labour has adopted a new philosophy centred on security (aka "securenomics"): economic stability, national security and border security. On the domestic front, it is planning far-reaching supply-side reforms with a particular focus on private investment. The idea of partnering with companies is central to its ambition targeting a long-term industrial strategy.**
- **Internationally, Labour will try to negotiate a closer relationship with the European Union, probably in return for greater cooperation in European defence and security.**
- **In terms of fiscal policy, Labour is determined to observe the rule aimed at lowering the public debt-to-GDP ratio by the fifth year of the forecast (currently 2028-29). However, there is a change in the fiscal policy stance: the Labour would target a balanced current budget, allowing borrowing funds only for the purpose of investment.**
- **In the first few months after the election, Labour will probably be tempted to announce slight fiscal easing via an increase in public spending, both in terms of capital and current expenditures. These will inevitably have to be financed by tax increases or levies, although Labour is still ruling out any core tax hikes.**
- **In the medium to long term, if Labour fulfils its promises of stability, increased supply capacity and closer relations with the EU, it may have more leeway and consider a less restrictive fiscal policy.**

First Labour administration since 2010 on the horizon

Earlier-than-expected elections

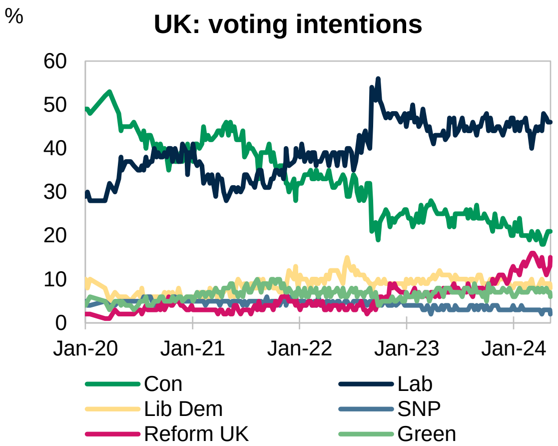
Unexpectedly, British Prime Minister Rishi Sunak announced on 22 May that the next general election would take place on 4 July. These will be the first elections since 1945 to be held in July. UK political observers were expecting elections to come next autumn. Rishi Sunak himself said several months ago that "his working assumption was that an election would take place in the second half of the year." July 4 seems early enough for the Conservative Party to try to close its considerable gap with Labour in terms of voting intentions, i.e. a gap of more than 20 points in the polls.

By calling for early elections, Rishi Sunak is denying the opportunity to benefit from a potential improvement in economic conditions or future rate cuts. He is most likely trying to take Labour by surprise, but it is certainly possible that Sunak will seek to capitalise on some of the recent positive economic newsflow: particularly with the economy coming out of recession in the first quarter with a stronger-than-expected rebound in GDP (+0.6% quarter-on-quarter) and inflation falling to a level (2.3% in April) that Sunak described as "normal".

That said, the Prime Minister's decision came on the very same day as the publication of April inflation data, which contained very unpleasant surprises and caused BoE rate cut expectations to get pushed back. Higher for longer rates would be poorly viewed by voters and further reduce the government's already limited fiscal leeway.

Polls point to a landslide victory for Labour and a large majority in Parliament

Polls on voting intentions suggest a massive victory for Labour, expected to gain a large majority in Parliament. According to YouGov, for example, the most recent poll to date (published on 30 May) gives Conservatives 21% of voting intentions and Labour 46%. Labour leader Keir Starmer is seen by far as the most likely next Prime Minister. Of course, uncertainty abounds and a lot can still happen between now and then, but so far the polls are predicting a strong Labour majority in the House of Commons[1]. This would already be positive for the UK, after the extensive period of political instability in recent years. Similarly, a large majority would guarantee a vote on Labour's reform plans without being pressured by left-wing factions of the party.



Source: YouGov, Crédit Agricole S.A.

Labour's economic platform: "securonomics"

Pending the publication of each party's manifesto, what do we know about Labour's ambitions and promises so far? The Labour Party has defined five missions to serve as a guide for the future government: "secure the highest sustained growth in the G7", "make Britain a green energy superpower", reform the healthcare system (NHS), reduce crime and create "opportunities for everyone". A plan called "securonomics", based on economic stability, national security and border security.

In a major speech given in March (annual Mais lecture), Rachel Reeves, the Chancellor of the Exchequer of the Labour "shadow government", detailed at length the party's vision of the UK economy. **Its approach to economic policy is based on three imperatives: stability, investment (public and private) and reforms.**

First pillar, "stability"

For Ms. Reeves, stability is the foundation of growth. It is derived first and foremost from the strength and reliability of institutions:

- ✓ Bank of England (BoE) – Labour has declared its total support for the independence of the BoE and plans to keep the inflation target unchanged at 2%. However, the BoE's mandate will incorporate a change: the introduction of climate transition into monetary policy.

- ✓ Office for Budget Responsibility (OBR) – Labour is considering a "new fiscal lock". When the government makes significant and permanent changes to public spending or taxes, the OBR will be required by law to produce forecasts. Labour intends to enshrine this already current practice into law. It also aims to halt the habit of changing fiscal rules whenever they become too difficult to follow. Going forward, the OBR will not be allowed to suspend the rules unless faced with an "economic crisis." It should be noted that this is a fairly vague condition, allowing for a broad interpretation.

- ✓ In order to reduce uncertainty over fiscal policy for businesses and allow them to make their investment plans, Labour wants to implement several changes: a single budget per year in the autumn, "a roadmap for business taxation" covering the duration of the parliament, within the first six months of the Labour administration, and capping the corporation tax at its present rate of 25% – the lowest in the G7 – throughout the next parliament.

Second pillar: investment

Recognizing that public investment is constrained by State finances, Ms. Reeves aims to stimulate private-sector productive investment through a "partnership with the State". Institutional reforms are central to this strategic partnership:

- ✓ Creation of **a new British Infrastructure Council**, made up of representatives of some of the largest UK and global investment funds, and legally strengthening the Industrial Strategy Council.
- ✓ **Commitment to the green transition.** Labour wants to increase public investment as part of its Green Prosperity Plan. At the heart of its net

[1] According to initial projections by YouGov, Labour should take all-time record 422 seats (out of 650 total) compared to 140 for Conservatives. Labour Party leader, Keir Starmer is poised to obtain a 194-seat majority in the House of Commons, besting Tony Blair's outcome in the 1997 election.

Slavena NAZAROVA
slavena.nazarova@credit-agricole-sa.fr

zero ambitions is the creation of two new institutions:

- Great British Energy (GBE), a new public company dedicated to increasing the production of clean energy (e.g. solar or wind), in order to achieve energy independence and ensure that 100% of energy is clean by 2030. GBE will also be tasked with saving GBP93bn for households, cutting energy bills for good and creating "thousands of good local jobs."

- *National Wealth Fund*, which will invest in new green industries (gigafactories, clean steel, renewable energy, etc.) throughout the country and in partnership with private companies. Under current plans, the National Wealth Fund will be endowed with GBP8bn (public and private funds). However, the party did not provide details on its funding, particularly whether the funds are already provided for in the current capital investment budget or new spending.

While Labour has reaffirmed its commitments to net zero targets and to green industries, it has nonetheless scrapped its GBP28bn-a-year plan to invest in clean industries.

- ✓ **Pension fund reform** to ensure that savings are invested in more productive assets generating higher yields. To promote innovation, Labour will end the practice of one to three-year funding cycles for major R&D institutions, replacing them with ten-year budget plans.

Third pillar: supply side reforms

These reforms aim to "unlock the contribution of working people and the untapped potential of the economy".

When it comes to infrastructure, Labour has ambitious targets. It stated that it is considering "a once-in-a-generation overhaul of the nationally significant infrastructure regime". The reforms would cover several key areas, including the housing planning system, public services and the labour market:

- ✓ **in housing**, reform of the planning system with the introduction of mandatory local housing targets, recruitment of "hundreds of new planners to tackle the backlog", and planning of the next generation of "new towns";

- ✓ more **decentralisation**, by giving more powers to regional and local governments in order to reduce interregional inequalities;

- ✓ **labour market reforms**, aimed at increasing flexibility and security in order to encourage employees to be more mobile. Labour believes this will help improve the total productivity of the economy. Among the planned reforms, Labour wants to guarantee "basic rights from day 1", such as protection from unfair dismissal, sick pay and parental leave, plans to prohibit zero-hours contracts and aims a reversal of changes made since 2010 in the legislation on trade unions (Trade Union Act). As part of its policies aimed at increasing labour supply, Labour promises additional investments in public services, particularly healthcare services, in order to bring back long-term patients who wish to return to work. In order to increase women's participation in the workforce, further reforms will be undertaken, including modernisation of the childcare system, easier financing for business creation by women and more efforts to reduce the gender pay gap.

Brexit: closer ties and pragmatism in relations with the EU

Although a majority of Britons seem to regret Brexit[2], none of the main political parties want to replace the Trade and Cooperation Agreement (TCA) with a stronger integration model, such as a customs union or single market membership, due to the constraints these solutions would entail (no possibility for an independent trade policy, regulatory alignment with the EU, free movement of persons, etc.).

While the business community has shown major dissatisfaction with Brexit, and a growing number of think tanks are seeking solutions for closer ties with the EU in order to remove some of the constraints weighing on export firms, Keir Starmer said he was against the UK's return to the single market for goods or the customs union and against the free movement of persons. At the same time, he is open to dialogue, having officially stated that he is in favour of "a closer trade relationship" with the EU, finding the TCA to be "too thin", and aims to seize the opportunity offered by the next mandatory review of the TCA[3] to renegotiate the agreement.

[2] According to a YouGov poll, around half of Britons (51%) say they are in favour of the UK rejoining the EU, compared with roughly one-third (36%) who say they are against it.

[3] The TCA contains a clause (Article 776) stipulating that "the Parties shall jointly review the implementation of this Agreement and the supplementing agreements and any matters related thereto five years after the entry into force of this Agreement and every five years thereafter". Provisionally applied starting on 1 January 2021, the TCA officially entered into force on 29 April 2021 after its approval by the European Council and Parliament.

Slavena NAZAROVA
slavena.nazarova@credit-agricole-sa.fr

His Secretary of State for Foreign, Commonwealth and Development Affairs, David Lammy, even had the ambition to review the TCA "page by page, seeking ways to remove barriers and improve opportunities for business." However, the complexity of the renegotiation process and the lack of political interest on the EU's part to renegotiate the deal has apparently caused Labour to rethink its strategy.

Press reports suggest Labour is now looking for an alternative way to rebuild its relationship with the EU through "a new security and defence pact." Labour is likely seeking a fairly broad definition of the term "security" in order to reach agreements with the EU in related areas such as technology, energy, climate transition, immigration, etc. Generally, Labour seems to be open to dialogue and more flexible regarding the notion of regulatory alignment or even when it comes to giving ground to the jurisdiction of the CJEU.

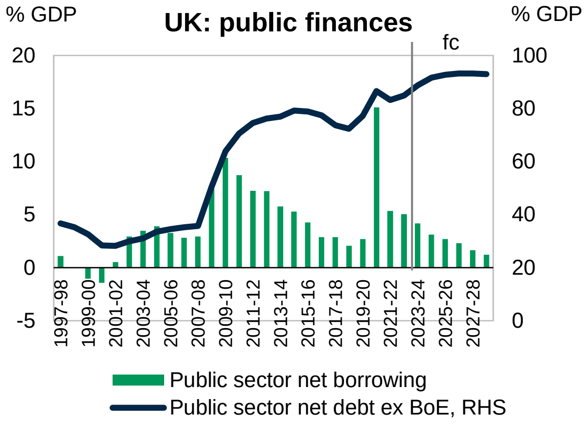
We are not yet at that point, however, and in the short term, the concrete provisions Labour would consider working on with the EU would remove certain barriers to trade in goods and services: a veterinary (sanitary and phytosanitary) agreement, mutual recognition of qualifications, youth mobility agreements and participation in the Erasmus student exchange programme.

Fiscal constraints

Labour will inherit a complicated economic and fiscal situation

The next government will have to put the country back on the growth track after a long period of stagnation in economic activity and loss of living standards. In an ageing economy subject to trade constraints with post-Brexit EU[4], the Labour Party is making potential growth and productivity its priority. It wants to increase investments. The fiscal situation is complicated, however: public deficit and debt are already very high (at 5.9% and 101.3% respectively in 2023, according to Maastricht Treaty measures, used to draw comparisons with EU countries) and leeway in relation to fiscal rules is very limited. Any additional spending will have to be financed, but there is strong resistance to higher taxes and duties given the substantial need for improved public services.

As the IFS explained[5], the next government has three options ahead of it: 1) agree to implement the spending cuts baked into existing plans, 2) increase taxes beyond what is already planned, or 3) borrow more. The latter would most likely mean breaking the rule according to which the debt-to-GDP ratio (as measured by public net debt excluding the BoE) has to fall by the fifth year of the forecast (currently 2028-29). According to the latest OBR forecasts (published in March 2024), this rule is currently met with the thinnest of margins: GBP8.9 bn, or 0.3% of GDP. The debt ratio is only expected to fall in the very last forecast year, to 92.9% of GDP, after reaching 93.2% in 2026-27 and 2027-28. Furthermore, the OBR's forecasts are based on relatively optimistic economic assumptions, which reduces the possibility of positive surprises in terms of revenue or debt servicing cost. The OBR forecasts GDP growth of 1.85% on average over the 2025-2028 period (after 0.8% in 2024), hourly productivity growth of 0.9% per year over the next five years (against 0.6% per year on average since 2010), inflation below the 2% target from Q2 2024 (1.75% on average between 2025 and 2028) and market expectations for the key rate lower than those currently known (4.2% in Q4-2024 and 3.3% in the medium term). If the next government wants to increase public spending, the economy needs to outperform the OBR's forecasts or the BoE has to cut its policy rate more rapidly than assumed into the fiscal forecasts. What's more, additional costs have emerged since the OBR's March forecast, including the one-off compensation for the victims of infected-blood products (estimated at around GBP10bn) and increased spending on asylum applications and migration policies (additional GBP4bn each year).



Source: OBR March 2024

[4] The TCA ended the free movement of goods, services, capital and persons between the UK and the EU. In particular, it introduced barriers to trade in goods and services. Goods being traded are subject to border controls such as customs checks, rules of origin and sanitary/phytosanitary inspections.

[5] See "Public finances and the 2024 general election | Institute for Fiscal Studies (ifs.org.uk)"

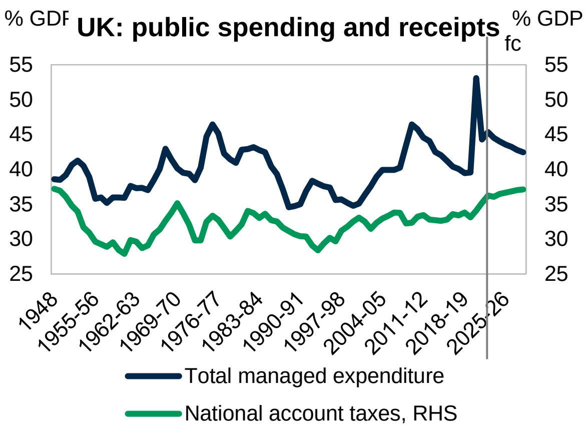
Slavena NAZAROVA
slavena.nazarova@credit-agricole-sa.fr

Fiscal rules: freeing up investment while stabilising the debt ratio

Acknowledging the extreme constraints on public finances, the Labour Party is considering making changes to fiscal rules to allow for an increase in public capital investment. However, it is firmly committed to fiscal discipline and has clearly stated that the main rule of lowering the public debt-to-GDP ratio within five years will be maintained. On the other hand, the current government's additional rule on the total budget deficit (aiming to reduce it to less than 3% of GDP) would be replaced by a rule on the current budget balance: any additional current expenditures would have to be revenue-funded. This would allow Labour to increase public investment as long as debt remains on a downward path in the medium term.

What tax increases might be in the cards?

In the first few months after the election, Labour is likely to announce some minor increases in public spending, both in terms of capital and current expenditures. These need inevitably be financed by higher taxes or levies. However, both Labour and the Conservative Party have repeatedly said they are not considering tax increases on top of what has already been announced. Indeed,Ms. Reeves definitively ruled out any future increases in income taxes, National Insurance Contributions (NICs), VAT (except on education in private schools) and the main corporation tax rate.



Source : OBR March 2024

Only a few specific tax increases were announced by Labour:

- ✓ exceptional taxes on oil and gas profits;
- ✓ additional measures against tax evasion, including the elimination of remaining tax exemptions for non-resident taxpayers;
- ✓ ensuring that multinationals "pay their share of taxes";
- ✓ reform of private school taxation (VAT).

However, the current fiscal situation could force Labour to announce tax increases. For example, it could reverse the NIC cuts decided by the Conservatives in recent years.

Conclusion

The next government will face many challenges: putting the country back on a path of sustained growth, boosting productivity and private investment, pursuing the green transition, improving the quality of public services, increasing defence spending, while ensuring the sustainability of public finances.

Labour's approach is promising, based on new concepts such as "industrial strategy", "business partnerships" and "strategic government", while at the same time being realistic in that it recognises the limits of the state and the central role of the private sector in investment. Public-private partnerships are central to Labour's ambition of a long-term industrial strategy. The key to success will be the government's ability to convince private investors. And for that to happen, Labour has yet to communicate the details of its strategy. The challenge is to avoid falling into situations like the one caused by the Liz Truss "mini-budget", where massive public spending is not financed by additional revenues.

Labour's economic objectives look sufficiently ambitious and broad-based to question whether they are compatible with fiscal rules, including the proposed new rule that would allow the government to borrow only to finance additional investments. The highly likely future Chancellor of Exchequer, Rachel Reeves, failed to explain exactly how she would reconcile fiscal rules with her economic stimulus goals. Promises not to raise taxes, though repeated many times, lack credibility.

In the medium to long term, hopefully, if Labour fulfils its promises of stability, increased supply capacity and closer relations with the EU, meeting the ultimate goal of increasing the potential growth of the UK economy, then it may secure more leeway and consider a less restrictive fiscal policy.

Slavena NAZAROVA
slavena.nazarova@credit-agricole-sa.fr

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Crédit Agricole S.A. — Group Economic Research
12 place des États-Unis – 92127 Montrouge Cedex

Publication manager: Isabelle Job-Bazille
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Contact: *publication.eco@credit-agricole-sa.fr*

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