Resolution Foundation

Doubling down on a bigger state

Assessing Labour's 2019 manifesto

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Labour have doubled down on plans to increase the size of the state, and their ambitious spending pledges have been matched by ambitious revenue-raising plans. There is now a very big choice facing the country on the size of the state it wants, and how it should be funded. Their manifesto also builds on the tax and spend focus of the 2017 predecessor, with much more radicalism in its approach to economic reform.

To-do lists are very useful things in life – keeping you focused on what you want to achieve while the world conspires to knock you off course. Election manifestos provide the to-do lists for any party that aspires to govern. And my-oh-my Labour's new to-do list is very, very long. That is both its strength, and its weakness. It is its strength because it shows that the party has an agenda – a view of the country and the change it wants to bring. But it is also its weakness because once a to-do list becomes too long it no longer helps you get anything done. It just stresses you out.

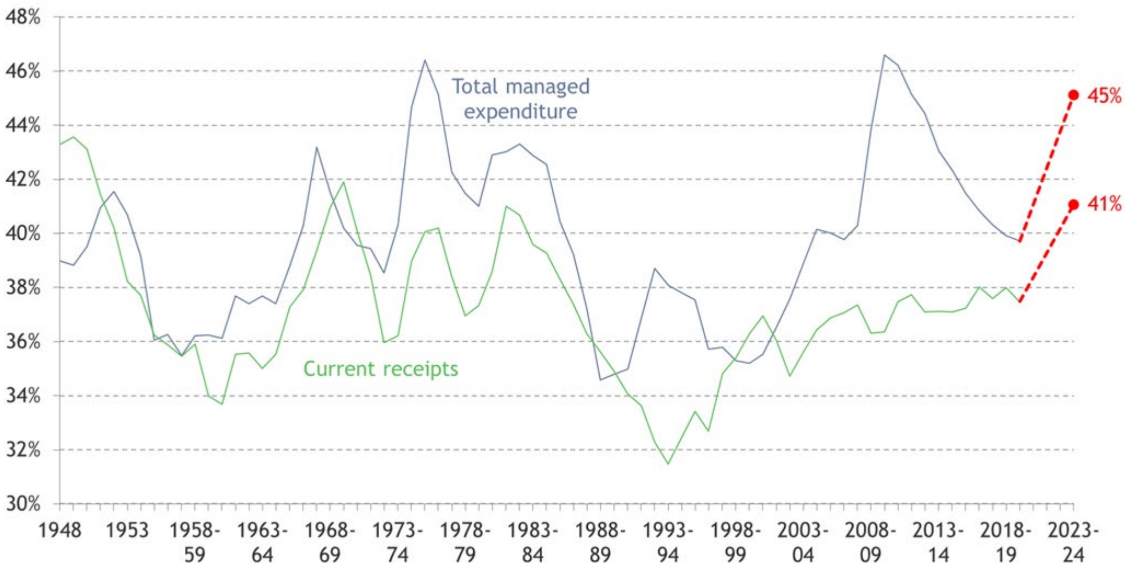
The big picture takeaway from the Labour's 2019 manifesto is: take the core anti-austerity message of its 2017 predecessor, ramp it up hugely and add in two additional substantive agendas that got much less focus two years ago – economic reform and climate change.

Ramping up the anti-austerity core is hardly surprising – the debate has changed drastically over the last few years so that austerity is ending, whoever wins. The Lib Dems yesterday proposed as big an increase in tax and spend as labour did in 2017. Meanwhile the Conservatives have also called for up to £20 billion of extra investment spending.

But if the state is getting bigger whoever wins, it's getting much, much bigger under Labour. The 2019 Manifesto literally doubles down on the spending increases in the 2017 manifesto – upping them from £70 billion to £135 billion. That £135 billion is made up of £55 billion of extra investment spending (with climate change much more of a priority than in 2017) and £80 billion on day-to-day spending (with free at the point of use social care the main new priority on a much longer list of promises, including free broadband). These, combined, would take our state from just below 40 per cent of GDP to the mid-40s (45 per cent without taking into account the impact of the huge fiscal stimulus on the size of the economy, and around 44 per cent with it included). These plans would represent the biggest increase in state spending (outside of recessions) since the first Wilson government of the swinging sixties, as shown in Figure 1.

Figure 1 **Labour's plans would dramatically increase the size of the state**

Government spending and current tax receipts as a share of GDP, actual and Labour's plans: UK

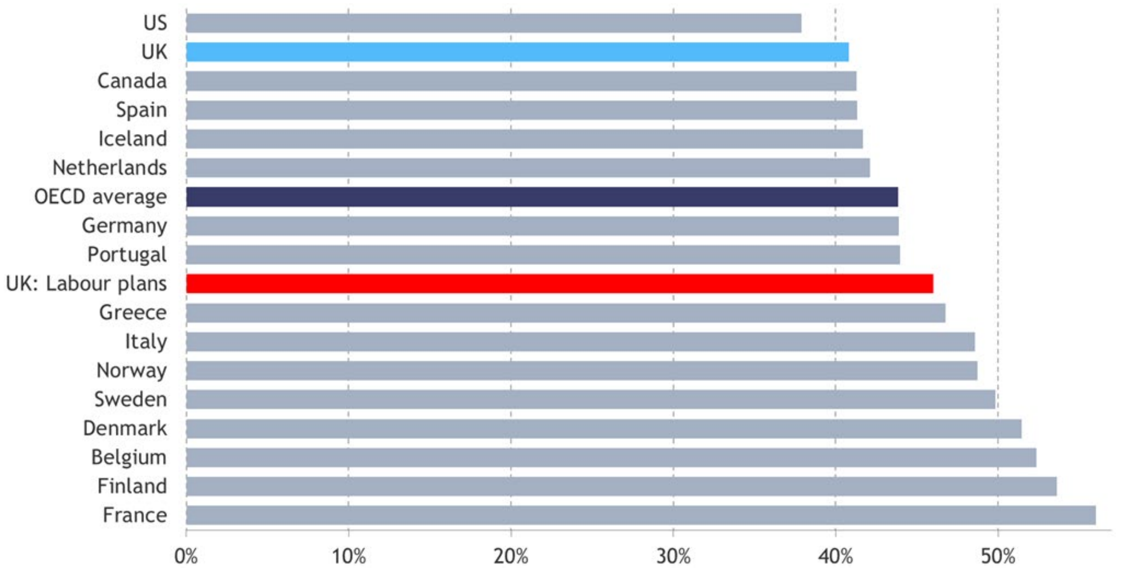


Notes: Switches from calendar years to financial years from 1955-56.
Source: RF analysis of OBR, *Public Finances Databank; Labour Party manifesto 2019*

This is a simply huge increase that takes us to a big state by historical standards. But the UK's state would still only be a little above the OECD average as a share of GDP, and roughly in line with Germany's, as shown in Figure 2.

Figure 2 **Labour would take the size of the state to slightly above the OECD average**

Government spending as a share of GDP in various countries: 2018 and 2023-24 Labour plans



Notes: Data for US is for 2017. 'UK: Labour plans' for 2023-24. Figures presented here are consistent with OECD data, which is slightly different from OBR fiscal aggregates.
Source: RF analysis of OECD, *General Government Accounts;* OBR, *Public Finances Databank*; *Labour Party manifesto 2019*

Tax

Labour's ambition on spending is matched by the party's ambition on tax. Again, starting with the big picture, Labour is planning to take tax revenues (in relation to the size of the economy) to a 50-year high, as previously shown in Figure 1.

In 2017, Labour's tax strategy focused on raising income tax on the top 5 per cent of the workforce – those with incomes of £80,000 or more. As the scale of the party's ambitions has increased, the relative importance of higher income tax to overall revenue-raising plans has diminished, despite its rhetorical prominence. The £5.4 billion Labour intends this policy to raise only represents a tiny part (under 7 per cent) of Labour's intended £83 billion of higher tax revenues.

The new addition on individual taxes in this manifesto is a plan to raise tax rates on capital gains (currently 20 per cent for a higher-rate taxpayer) and dividends up to the levels of income tax rates (40 per cent for higher-rate taxpayers). This aims to raise £14 billion. There are strong arguments for tightening up the UK's capital gains tax rules in particular. We've long argued for the scrapping of Entrepreneurs' Relief – dubbing it Britain's worst tax break – which Labour intends to do. Labour's proposal for a rate-of-return allowance within our capital gains tax system is also sensible, if not straightforward. The proposal on dividend taxation however is more challenging, given that corporation tax will already have been paid. The context here is Labour's plan to also significantly raise corporation tax to 26 per cent – its level a decade back. The UK should bring corporation tax reductions to an end, and could raise the headline corporation tax rate. But it is important to recognise that wider changes over the past decade that raise revenue mean that a 26 per cent headline rate would drive a significantly higher tax take than it once did. Who would eventually pay those higher taxes is complex, but it would include shareholders, workers and customers.

Higher capital gains and dividend taxation will most clearly be felt towards the top of the income distribution, although the scale of the tax increases proposed means that far more than the top 5 per cent of the workforce will be affected. As an example, higher corporation and dividend taxation will have a material effect on defined contribution pension schemes.

One advantage of the kind of reform Labour envisages in reconsidering how we tax corporations, dividends and capital gains is that it will narrow (although far from eliminate, given huge employee National Insurance differences) gaps between the tax treatment of different forms of income. These have provided very unwelcome tax incentives for people to be self-employed rather than employees, or to incorporate. Addressing this represents an important step towards both protecting the public finances and also avoiding people working without full employment rights.

Welfare

Labour has upped the scale of its plans on social security from 2017 (from under £5 billion to over £8 billion). But given the party's wider plan to go very big on state spending, the changes are still relatively small fry. The most significant proposal that wasn't there in 2017 is to scrap the two-child limit on support. This is very welcome, and alone should ensure child poverty is 300,000 lower, given its huge impact on some poor and large families.

On the overall generosity of the safety net, there are no proposals to row back the impact of the benefit freeze of the past four years, which has left the average couple with kids in the bottom half of the income distribution £580 a year worse off. This is in stark contrast to the commitment to a 5 per cent public sector pay rise to claw back some of the ground lost due to the public sector pay cap. As a result, significantly more than half of the post-2015 benefit cuts that the Conservative government still has in place would continue. There is, however, a much needed commitment to re-link housing benefit levels to rents in local areas.

By far the biggest spending commitment in the social security area is to scrap any further increase in the State Pension age beyond 66. This represents a significant cost pressure over the next few decades. There is certainly a case for reviewing the size and timing of further State Pension age increases in light of a recent slowing in the rate of improvements to longevity. But this change would clearly put more pressure on the working-age population, who have experienced much weaker relative living standards improvements than pensioners in recent decades. It is also hard to justify the now cross-party consensus on returning free TV licences to better-off over-75s, while huge cuts to the incomes of much poorer working families are left in place.

Economic reform

The scale of Labour's proposals has also become hugely more radical (and numerous) when it comes to wider economic reform. In 2017 that agenda was largely subsumed into a row about nationalisation, extra employment rights and a never-discussed plan to reintroduce sectoral bargaining. This time proposals go much further, on ownership and corporate governance, as well as the much-discussed addition of broadband to the nationalisation list.

The collective bargaining commitment (with workers having their pay determined between their representatives and those of firms at a sector level) returns in 2019. Partly because it went so unrecognised two years ago, it's worth reiterating what a huge change this would represent. To provide some sense of the scale of the shift, consider that getting collective bargaining coverage to all workers would mean that somewhere in the region of 20 million more employees would have their pay set by negotiations between bosses and unions than is currently the case. That's roughly twice as many employees as would benefit from Labour's share ownership plans (on which more below); around three times as many as would be affected by the minimum wage rising to £10 an hour (see our previous note); and 20 times as many as would be affected by the abolition of zero-hours contracts.

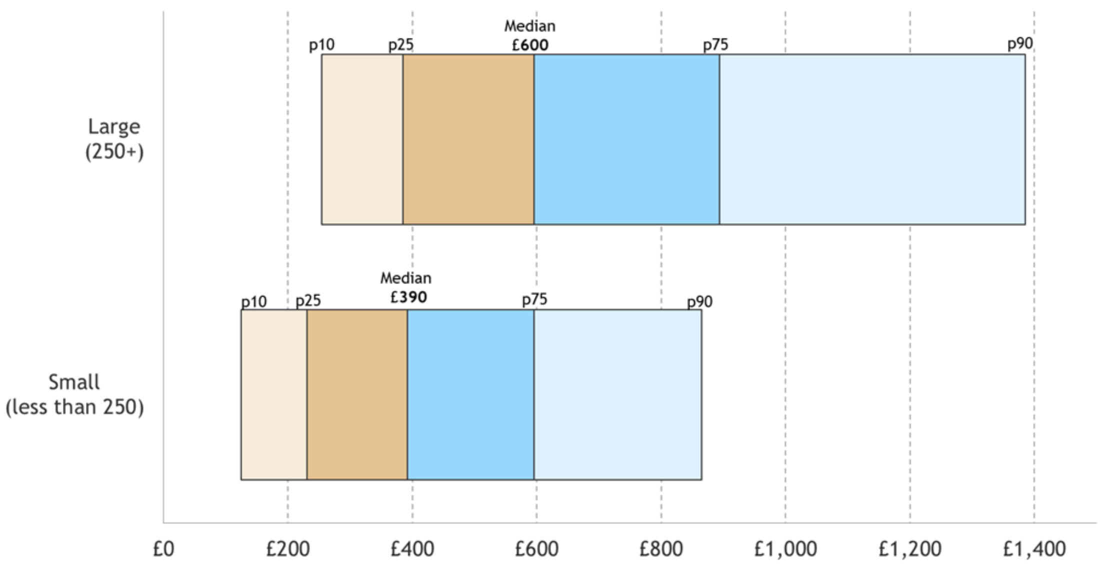
The single biggest addition to Labour's economic reform agenda is their shares-for-workers plan – Inclusive Ownership Funds (IOFs). This is a big, controversial and difficult change that has two objectives that are well worth considering separately – to give workers more control of the firms they work in, and to more evenly spread capital income (because workers would receive dividends up to £500).

Giving workers a greater voice in the running of the companies where they spend their days is a good idea, with a strong pedigree. There are reasons for hoping it would improve productivity, and it might also go some way towards reducing wage inequality within firms once workers are included in agreeing overall pay strategies. But Labour does have another, simpler, policy that delivers on this – proposing to put workers on all boards, thereby filling the glaring omission of any real proposals for corporate governance reform in 2017.

The profit-sharing element of the IOFs is far less convincing because, by applying only to larger firms, it will disproportionately go to already higher-paid workers. The typical weekly pay of someone working in a large firm (with 250+ employees) is over 50 per cent higher than the pay someone working in a small firm, as Figure 3 shows.

Figure 3 **Workers in large firms typically earn more than those in smaller ones**

Gross weekly private sector pay distribution by workplace size: UK, year to 2019 Q2, private sector only



Notes: This data uses self-reported workplace size, which is an imperfect proxy for firm size.
Source: RF analysis of ONS, *Quarterly Labour Force Survey*

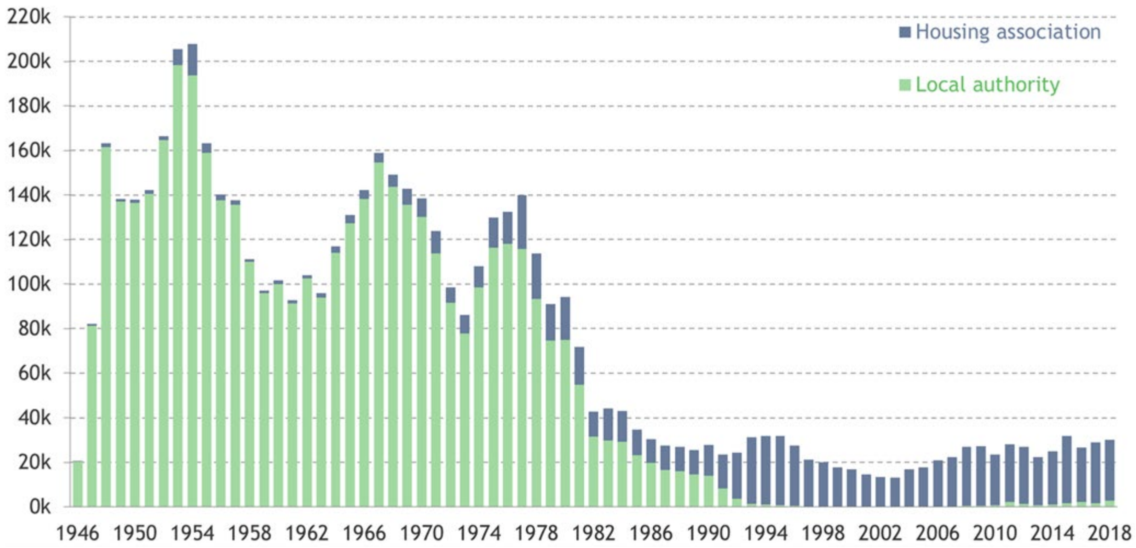
More importantly, it's not clear we actually want individuals' incomes to be any more dependent on which firm they work for than they currently are. Instead, we need to focus more on spreading rewards beyond those already lucky enough to work in the most successful firms. Possibly in part because of this worry, the policy is in practice a further selective increase in corporation tax for large firms (because any dividends over £500 per worker go to central government). This however only reinforces how dependent Labour's plans are on the huge amount of revenue that the party aims to raise from corporate Britain materialising.

Housing

The biggest housing policy in the Labour manifesto is a 50 per cent increase on the party's key 2017 housing pledge. Labour is proposing that within five years local authorities will be building 100,000 new council homes each year, alongside housing associations delivering a further 50,000 new homes at affordable rents linked to local incomes. The latest data (in Figure 4) shows that just 2,600 council homes were built last year – so Labour is proposing increasing the rate of council house building by a factor of almost 40 in just five years.

Figure 4 **Far fewer social homes are built today than in the post-war period**

Permanent social-sector dwellings completed, by tenure: England, 1946-2018



Source: RF analysis of MHCLG, *Live Table 244*

A step change in ambition on social housing is expensive (the party wants to borrow £75 billion for this purpose), but welcome. It is not without major challenges – labour, materials, land, and the knock-on effects on private supply are all factors that Labour's proposed Department for Housing will have to contend with. The political commitment that two-thirds of these homes be built by councils, rather than housing associations, also makes things more challenging as housing associations currently have much more experience and development capacity (Figure 4). Clearly, local authorities have built at much greater scale in the past. But if the goal is to see anything like the proposed increases in the next five years, collaboration rather than tension between councils and housing associations will be key.

In the short term, a policy affecting far more people is Labour's proposal to give private renters open-ended tenancies, rather than the current one-year norm. This is important, not least given the big rise in the number of families now bringing up children in the private rented sector. A necessary part of any system of longer tenancies is some degree of rent stabilisation to reduce the prospect that landlords will use big rent hikes to force out tenants anyway. Labour has proposed a hard rent cap in line with inflation. This may be too radical if it involves no ability to renegotiate real-terms rent levels over any length of time. But in the short term it is less radical than it sounds – since 2005 rents at a regional level have only grown faster than inflation in London (a likely reason for Labour also proposing that cities be given extra rent-control powers).

Conclusion

Labour's 2019 Manifesto is simply huge in the changes it proposes. Individually many are not out of line with other northern European countries. But taken together, they are a big step change from the plans Labour proposed just two years ago and more radical than anything we've seen in the UK for a generation (Margaret Thatcher's 1979 manifesto proposed far fewer changes). That is clearest when considering the proposed increase in the size of the state. But it is true also on proposals for deep economic reform – from our labour market to corporate governance and a big increase in public ownership.

With high inequality and stagnant productivity, none of us should be satisfied with the status quo. Indeed, there are very strong reasons for thinking that an increase in the size of our state and reform of our economic model are priorities for Britain. But despite having quite so much in it, Labour's manifesto is lacking some crucial ingredients for any would-be government wanting to embark on that journey.

First, prioritisation among such a long list of promises would be key.

Second, for any economic reform of this kind to last, much broader coalitions for it would need to be built than Labour has currently been able to secure (in contrast, see for example what the New Zealand Labour Party has been able to do on collective bargaining).

Third, more honesty about the difficulties involved would be needed. For example, such an agenda would have to involve much more of a focus on wealth taxes. And while more can be raised from the top, the reality is we will all need to pay higher taxes if we want a state the size of Germany's that delivers not just free social care but free broadband.

Fourth, acknowledgement is needed that any attempt to implement this programme would be happening against the backdrop of ongoing Brexit-driven (and indeed global) economic uncertainty. The goal has to be to tackle, rather than reinforce, the disastrously low business investment that is holding back growth today and family living standards tomorrow. Labour's approach aims to reform capitalism rather than end it, but is predicated on us being able to sort out Britain's productivity crisis via state-led investment and control rather than also finding a way to get British business to do more. It's a big bet.

Labour hopes its hugely radical programme will refocus the election campaign on domestic policy issues and away from Brexit alone. That may or may not happen, but what is certain is that if Labour forms the next government, the party is going to have one hell of a to-do list. And, as we all know, a long to-do list risks becoming something very different – a wish list.