National Institute of Economic and Social Research

A Macroeconomic Analysis of the Main Parties' Spending Pledges

Ed Cornforth

NIESR General Election Briefing

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National Institute of Economic and Social Research
2 Dean Trench St
London SW1P 3HE
T: +44 (0)20 7222 7665
E: enquiries@niesr.ac.uk
niesr.ac.uk
Registered charity no. 306083

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Introduction

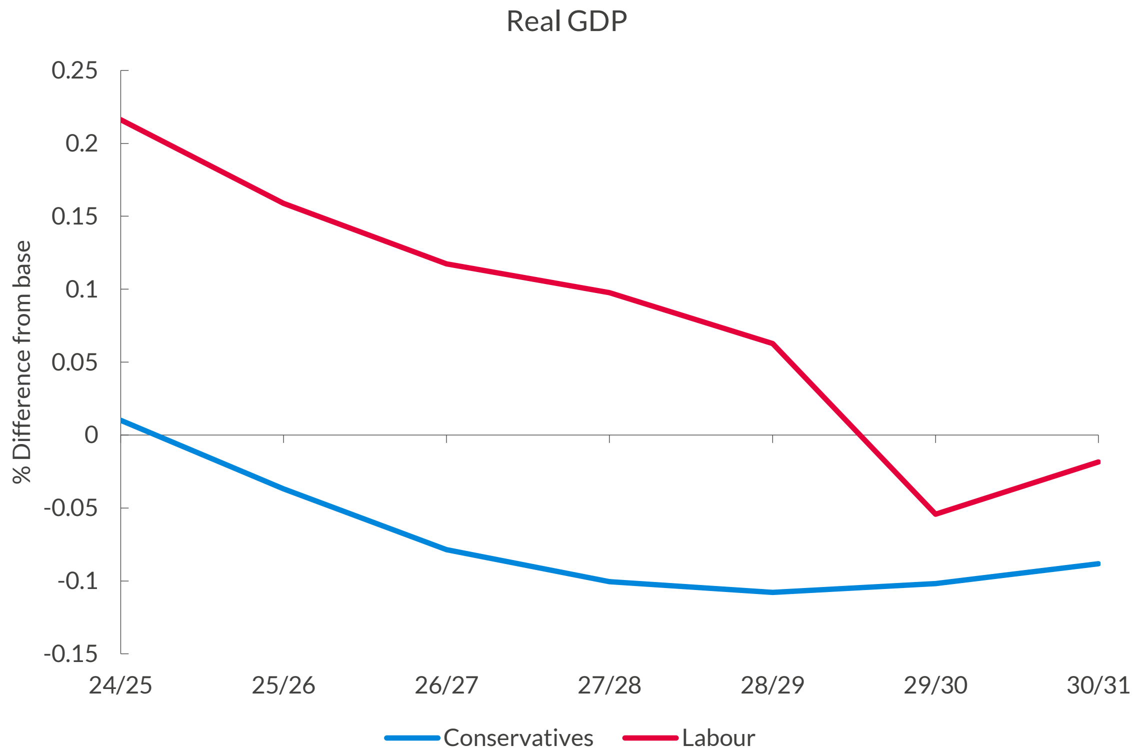
Using our global econometric model, NiGEM, and the figures from the Conservative Costings Document and Labour's Fiscal Plan, this briefing provides some analysis around possible macroeconomic impacts of the Labour and Conservative parties' spending pledges, as found in their respective manifestos. In doing this it has been necessary to make some assumptions, all of which have been outlined in a dedicated section at the end of this document.

The key findings are as follows:

- Labour's tax and spending plans increase real GDP by an average of 0.1 per cent over the next five years, driven primarily through investment via their Green Prosperity Plan. The Conservatives' tax and spending plans' decrease real GDP by an average of 0.1 per cent.
- Although neither party would meet current fiscal targets, the Conservative plan slightly improves the public finances relative to NIESR's baseline forecast. Labour's initial investment in the Green Prosperity Plan slightly increases the debt-to-GDP ratio.
- Both parties' plans would have a positive impact on business investment. Labour's plans would boost it by 0.6 per cent on average driven by productivity gains and increased economic activity. The Conservatives' plans would boost it by 0.5 per cent on average, driven by lower long real rates.

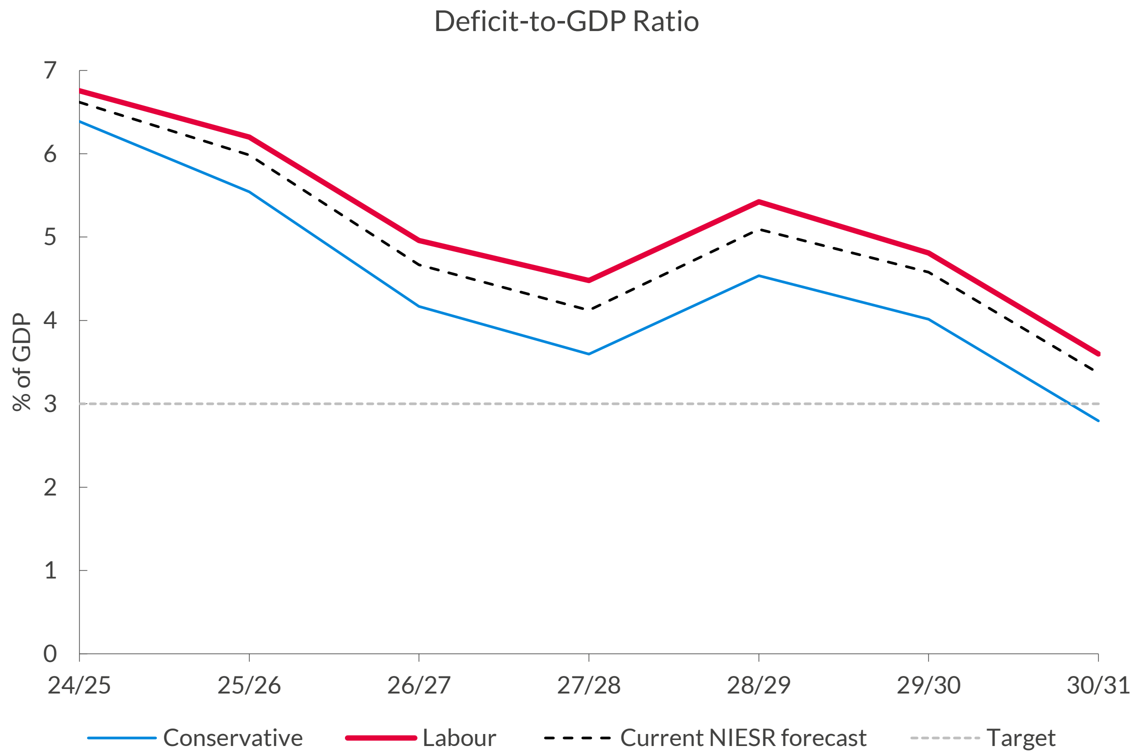
The Macroeconomic Impact

The impact of both party manifestos on real GDP can be seen below. There is a rise in real GDP as a result of Labour's Green Prosperity Plan; this is assumed to be a one-off investment over the next five years. There is a dip once the Green Prosperity Plan ends, but real GDP rebounds as the supply effects of the investment kick-in. Indeed, the effect on GDP becomes positive again beyond the 5-year horizon, being about 0.77 per cent above the baseline forecast on average from 2031/32 to 2035/36. The Conservatives impact on real GDP is very slightly negative - cuts to spending are partially offset by some increases in spending elsewhere and tax cuts, but not fully.



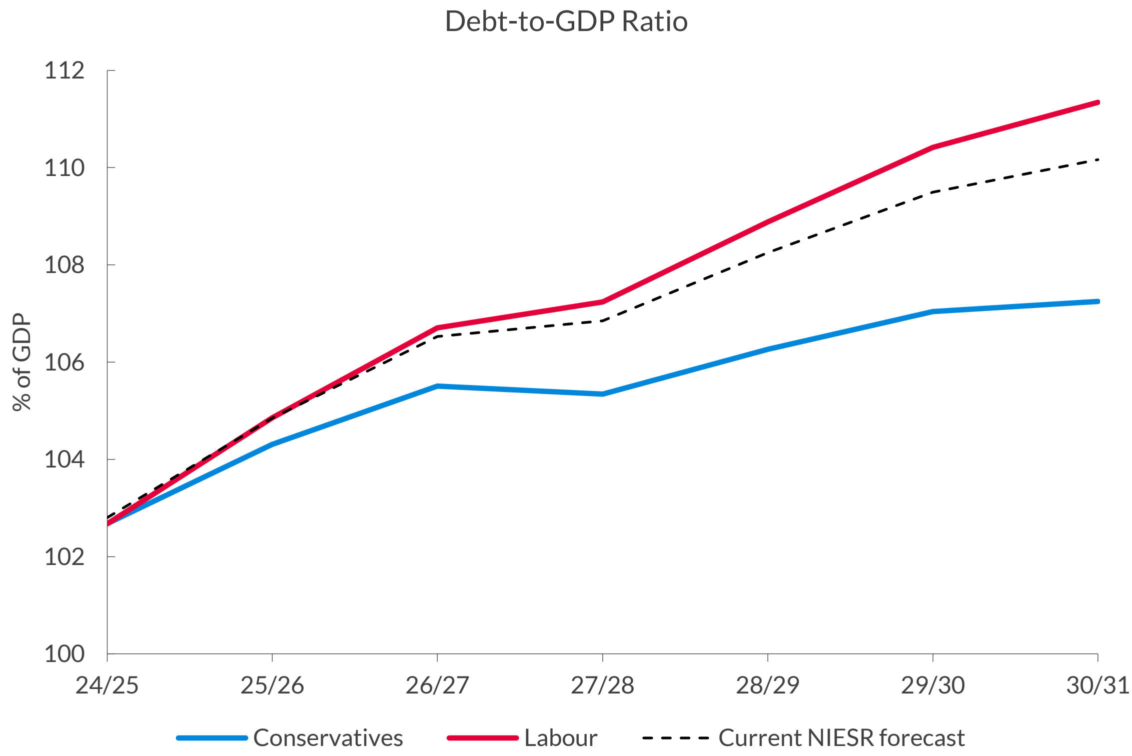
Public finances improve under the Conservatives and decline under Labour. This is partly due to Labour's debt financed Green Prosperity Plan, which is not completely offset by a windfall tax, and resulting higher interest payments. NIESR currently forecast that the government's current spending plans won't meet the 3 per cent deficit-to-GDP target until 2031/32. The primary driver behind this is our forecast for growth in real GDP- higher growth leads to higher tax receipts, as well as affecting the denominator of the deficit-to-GDP ratio. In NIESR's Spring forecast, GDP growth was expected to average 1 per cent per annum. However, to meet the deficit-to-GDP target of 3 per cent at the end of the 5-year period, real GDP would need to grow by an average of 1.65 per cent per annum.

Under the Conservative spending plans, they would meet this target a year sooner, in 2030/31. However, neither party would meet the target by 2028/29, at the end of the 5-year target window. The Conservatives would be above target by about 1 percentage point (needing an extra £8bn revenue a quarter), while Labour would be above it by about 1.5 percentage points (needing an extra £12bn a quarter).

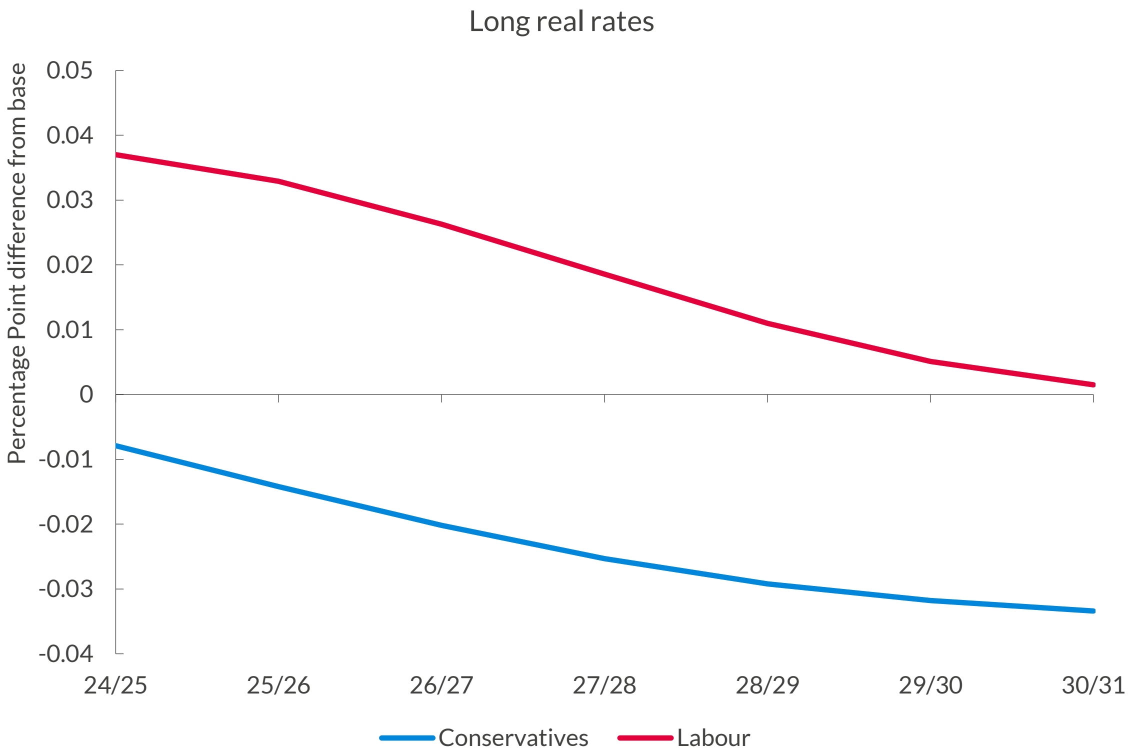


One point to note is that Labour's manifesto suggests a change to the fiscal rules that sees investment expenditure taken out of the deficit-to-GDP equation, so that it is just the "day-to-day costs are met by revenues". Recalculating the deficit-to-GDP ratio along these terms (taking out investment expenditure), the deficit-to-GDP ratio under labour would be 1.14 per cent by 2028/29 - missing what would presumably be a new target of 0 per cent. However, beyond that 5-year horizon the deficit-to-GDP ratio falls below this target. NIESR has previously called for the fiscal framework to be reconsidered. As explained in this General Election Briefing, this move seems to be in the right direction since it reduces the disincentive for public investment.

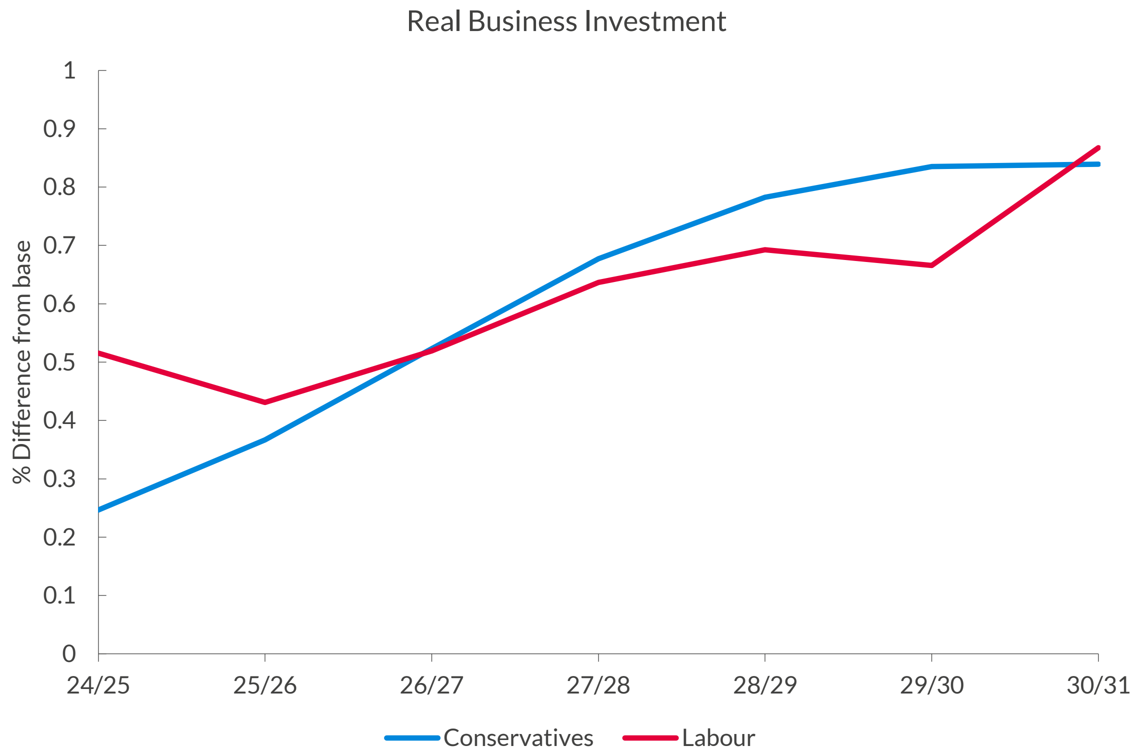
The debt to GDP ratio shows an increase under Labour's plans against current NIESR forecasts, and a decrease under the Conservative plans. In terms of meeting fiscal targets. Neither the Conservatives nor Labour will have the Debt-to-GDP ratio falling until 2030/31. To meet the current target - that is to have the debt-to-GDP ratio falling at the end of the 5-year period - the Conservatives would need it to fall by 1 percentage point in 2028/29, about £32bn, while Labour would need it to fall by 2 percentage points, about £65bn, and not rise further.



The extra investment from Labour leads to a higher policy rate, as extra demand in the economy means the central bank needs to keep rates higher for longer to tame inflation. Long real rates increase by about 3.7 basis points. In contrast, as demand and the debt burden fall under the Conservative plans, inflationary pressures ease. This leads to a lowering of the long real rate by about 3.5 basis points in the long run. It's important to note that this effect is so small as to be effectively zero.



Both parties' plans lead to a rise in business investment. Under the Conservative plan, lower interest rates lead to a lower cost of capital - businesses invest more as a result. Under the Labour plan, there is a very slightly higher cost of capital, but this is offset by the productivity gains, especially under the Green Prosperity Plan which crowds in business investment. In the long run this starts to drop back down as the higher rates take effect.



Key assumptions

- All figures are taken from the Conservative Costings Document (https://public.conservatives.com/static/documents/GE2024/Conservative-Costings-Document-GE2024.pdf) and Labour's Fiscal Plan section of their manifesto (https://labour.org.uk/change/labours-fiscal-plan/).
- All parties' expenditure is taken as read from their manifestos; that is, if a party assumes that changing a measure will generate a certain amount of income, this is taken as given and not questioned as to whether it is achievable or realistic. Expenditure data is based on the Fiscal Year 2028/29 as that is the only year Labour provided in their "Fiscal Plan" section; I assumed the same year for both parties for comparability.
- Some costs are one-off. For example, we assumed that "Double NHS CT and MRI scanners" would only need to be done once.
- We assume that the costs of any announced policy grow in line with overall government expenditure as currently predicted. So, if Policy A is equal to 1 per cent of government investment in real terms in Fiscal Year 2028/29, it will be equal to 1 per cent of real government investment in all other years.
- Policies related to education or mental health are assumed to be a form of investment (assuming there is a link between these areas and productivity, investment would be a proxy for productivity enhancing expenditure even if it doesn't contribute directly to capital stock). This amount is roughly the same for both parties so benefits them equally.
- Tax rates have been calibrated to match the average income that is stated for the parliamentary term (so if the party claims to raise taxes and provide £1,000 in

revenue in Fiscal Year 2028/29, the tax rate is matched to provide an average of £1,000 in revenue in the 2024 - 2030 period.)

- The windfall tax, as a one-off tax on excessive profits, was modelled as a direct shock to government debt without changing tax rates. Therefore, it does not show up in the deficit-to-GDP ratio.

Methodology

We used our global econometric model, NiGEM, to provide this analysis. In NiGEM, government expenditure is aggregated into consumption, investment, and social transfers. Likewise, taxation is split into indirect tax, income tax, and corporation tax. The core assumptions in the analysis revolve around which items of expenditure match up with which NiGEM variable, as different variables flow through into the economy in different ways. Investment expenditure and corporation taxes directly affect capital stock, and therefore the long run supply capacity of the economy. It is also a direct component of GDP. Consumption expenditure is a direct component of GDP but does not affect other variables except through this channel. Transfers and income taxes do not directly affect GDP. Instead, they flow through into income, which affects consumption and GDP indirectly. Indirect taxes affect consumer prices, mainly working through the consumption and inflation channels. A comprehensive description of the model can be found in Hantzsche, Lopresto, and Young (2020).

The matching of revenue and expenditure measures are outlined below:

LABOUR		CONSUMPTION	INVESTMENT	TRANSFERS	INCOME TAX	CORPORATION TAX	INDIRECT TAX	OTHER MEASURES
REVENUE (£MN)	Closing non-dom tax loopholes				-5230			
	VAT to private schools						-1510	
	Closing carried interest tax loopholes				-565			
	Stamp duty						-40	
	Windfall tax							-1200*
EXPENDITURE (£MN)	40000 more operations	1010						
	Double NHS CT and MRI scanners		250*					
	Dentistry package	125						
	Free school breakfast	315						
	Investment in HMRC	855						
	6500 new teachers		450					
	Increased teacher/headteacher training		270					
	Work experience/careers advice	85						
	ELD in primary schools	5						
	Ofsted reform	45						
	3000 new nurseries	35						
	Mental health support for schools		175					
	Young futures hub	95						
	New mental health staff		410					
	Legal Aid	30						
	Visa costs for non-UK veterans	10						

LABOUR		CONSUMPTION	INVESTMENT	TRANSFERS	INCOME TAX	CORPORATION TAX	INDIRECT TAX	OTHER MEASURES
	300 new planning officers	20						
	Barnett Consequentials	650						
	Great British Energy		1700*					
	National Wealth Fund		1500*					
	British jobs bonus		300*					
	Warm homes Plan		1100*					
	Barnett Consequentials		200*					
	* These measures are assumed to be one off costs that apply just for the parliamentary term							
	Total	3280	6355	0	-5795	0	-1550	-1200

CONSERVATIVE		CONSUMPTION	INVESTMENT	TRANSFERS	INCOME TAX	CORPORATION TAX	INDIRECT TAX
TAX CUTS (£MN)	Employee NIC				10000		
	Self Employed NIC				1667		
	Triple Lock Plus				2200		
	HICBC			1179			
	Abolish stamp duty						555
	Suspend CGT on tenant sales						
OTHER MEASURES (£MN)	Welfare Reform			-11000			
	Tax avoidance				-5000		
SPENDING (£MN)	Defence	4500					
	of which R&D	-1600					
	Civil Service headcount	-2900					
	Help to buy			0			
	250 GP surgeries	183					
	50 CDCs	372					

CONSERVATIVE		CONSUMPTION	INVESTMENT	TRANSFERS	INCOME TAX	CORPORATION TAX	INDIRECT TAX
	Pharmacy first	250					
	Mental Health		595				
	Savings on consultancy spend	-630					
	5500 fewer NHS managers	-440					
	New apprenticeships		722				
	Savings on low value degrees	-903					
	8000 Additional police officers	779					
	Visa charges			-380			
	National Service	500					
	Farming budget indexation			330			
	Quango efficiencies	-1129					
	Other measures	-635					
TOTAL		-1653	1317	-9871	8867	0	555