LABOUR'S NEXT GOVERNMENT

'Riders on the Storm': what would a Labour government face?

Gavin Kelly and Nick Pearce

A future Labour government will face difficult circumstances – a stagnant economy, household hardship, political volatility and a weakened state. It will need to carefully plan a programme of economic reform while fleshing out its intellectual foundations – and maintaining a broad coalition of support.

How should we think about the prospective governing agenda of an incoming Labour government in 2024? Labour administrations have often come to power after long periods of Conservative or Conservative-led government, as they did in 1945, 1964 and 1997, borne into office on the back of accumulated popular demands for national renewal and social change. By contrast, when Labour has replaced single-term or short-lived predecessors, as it did in 1924, 1929 and 1974, the party has entered power as a precarious minority government or an administration resting on a barely workable majority. Labour has also often inherited significant, crisis-laden economic challenges on taking office, and if Labour forms a government in 2024 or early 2025, it would likely face a combination of these circumstances: fundamental economic problems and pressure for social reform that have steadily built up since the party's defeat in 2010, twinned with the political precarity and electoral volatility generated by weakening partisan allegiance and a decade of crises and shocks ranging from the Scottish independence referendum to Brexit, the Covid-19 pandemic, and the invasion of Ukraine.

How a Labour government responds to these circumstances would be shaped by at least three factors: the precise economic inheritance of the new government; its own ideology and the wider climate of ideas; and the nature of the electoral and political-economic coalitions that have brought it to power. Doubtless there are other issues that will be of interest to political commentators, such as political leadership, party management and administrative capability, but we choose to focus here on the factors we consider most important to understanding the agenda and prospects of a putative Labour government.

The economic inheritance

A central factor is the nature of the economic inheritance. For much of the post-war period the UK economy performed respectably, if not remarkably. Despite periods such as the mid-1970s, when the UK under-performed in comparison to many other countries on various indicators, the trend in real wages remained strongly positive: up by 33 per cent a decade on average between 1970 and 2007. In the two decades prior to the 2008 financial crisis, the UK economy achieved steady growth, and actually outperformed a number of peers, achieving a modest catch-up in productivity. As such, despite the claims of its critics, the UK's overall performance across the long post-war era was not one of remorseless decline – though it is certainly true that the UK de-industrialised particularly sharply, and that inequalities between people and places exploded in the 1980s, casting a long shadow we still live under today.[1]

Since the financial crisis in 2008, however, the UK economy has performed unquestionably badly by historical and comparative standards. There are multiple compounding reasons for this: the triple shocks of Brexit, the Covid-19 pandemic and the fallout from Russia's invasion of Ukraine came on top of a decade of austerity, which itself overlaid long-term imbalances in the UK economy. The combined result is that the UK approaches the mid-2020s in an unusually weak position. With growth stalled, living standards falling and state capacity diminished, the UK is fiscally stretched, eyed sceptically by international capital markets, and lacking any clear sense of its future economic strategy.

It is hardly news that the country faces an economic malaise. Yet prevailing opinion hasn't fully registered what this means for a future government. The UK's current problems are not a blip, or a passing phase, but have become entrenched. Real wages have stagnated so severely they are back to the level they were at in 2005. A quarter of the UK workforce has never known what it's like to be employed in an economy capable of generating steady wage gains. Stagnant productivity – which has advanced at a crawling rate of 0.4 per cent since the financial crisis – in no small part reflects a longer-term failure to invest. The UK has spent most of the past two decades languishing near the bottom of the high-income OECD business investment league table, with Brexit then compounding this problem.

The responses to more than a decade of shocks, together with this disastrous record on growth, has given rise to the UK's weakened fiscal position. The debt to GDP ratio stands at 100 per cent, compared to 38 per cent in 1997 (which then fell below 30 per cent through New Labour's first term). Today's public services are grossly under-funded at the same time as the tax share has risen sharply. The scale of the problems in our public services is not just damaging the nation's social fabric but is also materially holding back the productive capacity of the economy. The UK has become a test case demonstrating that when public investment and spending is choked – across health and care, education, and employment support – economic potential is lost.

For an incoming government simply to deal with the urgent social repair necessary to keep services functioning – settling major workforce unrest, making inroads into the enormous NHS backlogs, ensuring schools have enough qualified staff, preventing care workers leaving for higher pay in supermarkets, and so on – is going to be expensive, contentious and hugely time-absorbing. And all that is before any attempts to renew, let alone transform, key public services and the wider welfare state: whether via a new social care settlement, setting a path towards a fully universal childcare system, forging a new child poverty strategy, rebalancing towards preventative health care, or creating a new generation of social housing. On top of these longer-term agendas, we also need to add the steady upward pressure arising from an ageing society, the sustained investment needed to make up lost ground on Net Zero, and the imperative of replacing carbon-related revenue streams.

All incoming Labour governments tend to generate frustration as pent-up social demands collide with competing priorities and the grindingly slow business of bringing about noticeable change. But these challenges would be of a different order in the mid-2020s. Expectations about what government can achieve may have declined, but any political protection this offers is more than offset by the sheer scale of the task of keeping the show on the road.

This is a starkly different legacy to that in 1997. Admittedly, New Labour also took office against the backdrop of increases in taxation in the years following the

Exchange Rate Mechanism crisis, albeit from a lower base. But that is where the parallels end – which limits how many direct policy lessons can be learned from this period. Wage levels were rising steadily in the mid-1990s, rather than falling back to 1979 levels, which would be the equivalent of today's stagnation-era reversal. Productivity was still growing very respectably at over 2 per cent per annum, and, accordingly, tax revenues were rising steadily at constant tax rates. The global context was benign as the opening up of world trade resulted in cheaper goods and pressure for productivity gains, and certainly by the standards of recent years, there were few shocks to manage before 2008. There was, of course, a deep social, democratic and institutional malaise in the UK to address. But despite various underlying frailties in the British model – not least its record on investment, stubborn inactivity and long-term unemployment, and exceptional inequality – there was still an economic platform on which to forge a new governing agenda. It was overwhelmingly a moment of opportunity rather than peril, as arguably it was for Harold Wilson's government in 1964, despite the looming prospect of a balance of payments crisis and Sterling devaluation. Neither Wilson in 1964 nor Blair in 1997 had to reckon with a nation stuck in a rut of economic stagnation.[2]

Nor can we view the economic legacy purely through the rear-view mirror, since decisions about future spending that have already been taken are likely to shape events for a period after the election. The current government's assumptions for public expenditure until 2028 – which sets the baseline for any new administration – are so implausible that it seems almost bound to duck any Spending Review before the next election, as this would only crystallise the depth of further cuts in store for 'non-protected' public services (an implied additional 14 per cent reduction in spending per head by 2028).[3] On taxation, which has already risen by 4 percentage points of GDP over recent years, there is another 1 percentage point rise baked in by 2028. The question isn't whether taxes will rise – that's a given whoever wins the election – it's how much further still they may need to go up, and, crucially, whether the next government will be willing to make vital but contentious reforms to improve the efficiency and fairness of our dysfunctional tax system.[4]

Likewise, when it comes to monetary policy the impact of recent repeated interest rate rises, which are expected to continue through the rest of 2023, will still be playing out over the first half of the next Parliament. But there is radical uncertainty over how far this goes. The dominant market view is that we should anticipate a prolonged period of high inflation and seriously elevated interest rates, which would not only spell intense pain for the UK's mortgage-holders and many businesses, resulting in higher unemployment and an economic downturn, but would also ratchet up fiscal pressures via elevated debt interest payments. The weight currently given to this scenario has perhaps resulted in an under-pricing of the likelihood that summer 2023 marks the peak of inflation and interest-rate pessimism. Under this alternative version of events, the UK may have already over-corrected on monetary tightening, and inflation is likely, belatedly, to start to fall more in line with those of our peer nations, enabling interest rates incrementally to come down as we move through 2024. If the structural pressures that drove rates downwards over recent decades haven't all suddenly relented, we might expect the costs of borrowing to moderate over the next Parliament, though not back to post-2008 lows.

This macroeconomic uncertainty reinforces the risk that an already grim inheritance generates a self-fulfilling mood of fatalism, paving the way to a politics of stunted ambition. Balance is needed. For all the UK's challenges, it may well be the case that the worst of the aftershocks arising from Brexit, Covid and the invasion of Ukraine are behind us. There should be a significant stability-dividend on offer to an administration demonstrating basic competence and governing purpose. Some improvements in our trading relations with the EU should be realisable, creating a new dynamic. And if there is any sort of silver lining at all to the UK's lost decade and a half of productivity failure, it is that there is a huge amount of catch-up potential to be realised before the UK gets anywhere close to the global frontier.

Nor should the fog of gloom blind us to the fact that – contrary to the popular mood – on some issues, at least, the social context is brighter than it was in 1997. There are significantly fewer workless young people compared to the mid-1990s, and a far higher share of graduates in the workforce. School performance is up in relative and absolute terms. Greater Manchester and the West Midlands now have far greater capacity to come up with their own solutions, creating a path that other key city-regions can follow. The UK's pension system certainly needs reform but pensioner poverty has fallen significantly in recent decades and there is a solid infrastructure to be built upon. More broadly, the rapidity of the UK's deindustrialisation in the 1970s and 1980s means that the Net Zero transition – at least when it comes to the jobs market – will be less disruptive here than in in some peer nations.

Fully appreciating the severity of the inheritance, while not being cowed by it, is thus essential for a new government. Understanding the position is politically crucial for incoming ministers, since it won't be long before they find themselves deemed to share responsibility for it. But it is important, too, because governing agendas are defined in no small part as reactions to the failings of what came before. The bleak seriousness of the 2024 legacy could, potentially, give a new Labour government definition: the questions it needs to answer will have been set.

Ideas and ideology

Ideas matter to an incoming government because they give energy and definition to a political project, as well as shaping policy. Parties use ideas to make sense of the world and to link their own programmes to the wider climate of opinion. In contemporary politics, ideas and policy programmes take shape in loose assemblages of sympathetic think-tanks, journalists, public intellectuals, party activists and civil society organisations.[5]

In recent years, Labour has prioritised party management over ideological development and, although it has taken political inspiration from the successful campaigns of sister parties in Germany and Australia, it has engaged less in intellectual exchange than New Labour did in the years leading up to 1997. Undoubtedly of greatest consequence for the economic thinking of the British centre left is the new 'Bidenomics' of the US Democrats. Policy transfer from North America is often influential within Labour Party circles, but the impact of the current US administration's agenda goes far beyond that. The huge programme embodied in President Biden's signature legislation of clean energy subsidies, infrastructure investment, healthcare, social security and R&D spending, and semiconductor manufacturing, is reshaping market understandings of, and media expectations about, the appropriate ambitions of the state in economic policy. It has legitimised large-scale industrial strategy for the Net Zero transition and the public investment needed to achieve it, while coupling this self-declared 'supply-side progressivism' to a new regime of corporate taxation, trade union rights and 'pro-worker' trade policy. This represents a major reinvention of twenty-first century American liberalism, and one which is already being used to reframe the economic and industrial policy ideas of the Labour Party. Driven in large part by antagonism with China, the Biden administration's agenda is also radically reshaping the geo-political context within which the UK must think about its defence and security strategies.

The Biden programme was launched before the invasion of Ukraine and in a different fiscal and monetary context to the contemporary UK one. But the influence of Bidenomics on the next government will be singularly important at the level of ideology because it mounts a challenge to the ideas embodied in the prevailing UK growth model – and the task facing a new government isn't just to resuscitate that model, but to reform it. The composition of GDP growth, for instance, needs to shift towards a prolonged period of investment growth, a precondition for progress on productivity, living standards and Net Zero. But higher investment ultimately needs to be paid for via increased savings by firms or households (a tough sell at a time of depressed wages), or by increasing the UK's already large current account deficit, at a time when the UK is already internationally exposed. Likewise, the embedded assumption that macroeconomic stabilisation is the sole preserve of monetary policy is both at odds with reality (witness the big fiscal response to Covid and surging energy prices) and serves to reinforce inertia when it comes to new thinking on how the broader policy framework should offset the distributional injustices of burdens and gains that arise from shifts in wider monetary conditions.

The UK's post-financial crisis trajectory has also intensified concerns about income and wealth inequalities, in contrast to the primary focus on poverty and social exclusion in the 'long 90s'. The incredible increase in the overall level of net wealth in British society – which rose from a post-WWII norm of three times GDP, to four times GDP by 1997, and then twice that again by the time of the Covid-pandemic – has highlighted concerns about intergenerational as well as class inequalities, and the way these block access to home ownership and social mobility, for the young and increasingly the middle aged too. This trend has powered a growing debate about how to rebalance the tax system towards a greater focus on wealth and assets rather than placing ever more emphasis on earned-income.

At the same time a new analytical focus in Labour discourses on the 'foundational' or 'everyday' economy, drawing on strands of academic thinking as well as innovations in Labour local government, has emphasised the importance of improving wages and conditions and ensuring dignity at work, especially in non-traded, low-paying, employment-rich sectors. Here the ideological imprimatur of the wider Anglosphere – whose liberal market economies share many institutional features with those of the UK – is also visible. These countries share common challenges around raising labour standards in economies where private sector unions have been in long-term decline, and where deregulation and contracting-out have generated concentrations of low-quality jobs. In New Zealand, Ireland and some US states, sectoral institutions capable of setting minimum standards on wages, conditions and training entitlements for workers are being developed, and these are influencing thinking in the UK.

European social investment state strategies remain a powerful current in social policy, as they were in the 1990s, but have been given new energy in the 2020s due to the impact of the under-resourcing of public services on economic performance. The need for social investment in skills training, childcare, public health, education and employment support remains acute. Meanwhile, the gender revolution in social policy has advanced across the OECD but remains incomplete in the UK, where the New Labour settlement in childcare, flexible working rights and parental leave entitlements has been maintained, and in some cases built on, but with lower levels of per capita funding. A key goal here should be moving towards a coherent, publicly-funded and organised system of early years education and childcare, rather than the patchwork of overlapping state funding streams and market mechanisms currently in place. This wider policy agenda –

pioneered by social-democratic feminists in the 1980s and 1990s – is likely to remain influential through the 2020s.

Austerity and the pandemic have exposed some of the lacunae of the UK's approach to social investment: rising destitution, poverty-levels of income support for working-age single adults, and income volatility for claimants of Universal Credit, to name a few. Labour market precarity and its link to income insecurity have given a new lease of life to demands for a guaranteed social minimum (as well as to supporters of a Universal Basic Income), as well as those seeking to redress the dysfunctions of ever more punitive benefit conditionality. These and other areas of social policy demand experimentation and innovation – and require reformers, as we have argued elsewhere, to learn from successful initiatives and fuse them together at a scale capable of realising new social ambitions.[6]

Coalitions of support

Building a coalition of support for governing through hard times has both electoral and political-economic dimensions. In the 1990s, 'Third Way' social-democratic parties successfully crafted new cross-class voting coalitions to replace the decline in their industrial working-class support, but these new voting blocs proved far less stable than those of the post-war era. Partisan allegiance has weakened since, and voters are now more likely to switch parties at general elections. In the UK, nearly half of all voters did not vote for the same party across the three general elections of 2010, 2015 and 2017, and on current opinion polls, the 2024 general election will renew this volatility, with a big swing expected away from the Conservative Party.[7] The implication is that governing parties – left or right – cannot expect support from a stable and secure electoral coalition, however large their majorities.

Meanwhile, party competition has intensified. Across Europe, parties of the social-democratic and centre left have generally lost vote share since the 2008 financial crisis, and now compete with the nationalist right for working-class support, and with greens and others for the educated middle-class vote. In the UK, the majoritarian electoral system for Westminster offers some insulation to the Labour Party, but at a price of requiring it to pre-assemble a broadly-based electoral coalition in order to win power, rather than negotiating a governing coalition to gain office. This electoral challenge is all the harder because of low turnout amongst younger voters, particularly young working-class voters, and the increasing concentration of Labour's support in cities and university towns, trends which have helped entrench the electoral power of Conservative-supporting older voters in recent years.

The age divide in British politics – in both turnout and party choice – has been particularly marked in the UK since 2010 compared to other OECD countries, and arguably reflects distinct features of the UK's post-financial crisis political economy. The young and university educated cluster in higher-skill agglomerations of cities characterised by broadly liberal values. Older voters have high levels of home ownership and dominate the electoral geography of post-industrial towns, counties and rural areas. They tend to be more socially conservative, and less socialised into the kinds of liberal values that permeate higher education and many professional service occupations.

Home-owning older voters profited from rising asset values in the era of loose monetary policy, and enjoyed relative protection from austerity, in sharp contrast to the younger working-age population. This generational political economy has recently been disrupted by the spike in inflation and interest rates – although the immediate effect on the older cohort of voters is muted because of the large proportion who own their homes outright. Whether it gets unravelled depends very much on whether we have moved into a 'new normal' of elevated interest rates rather than this being a temporary phase. If the former, this could significantly reduce overall levels of wealth relative to GDP due to a downward correction in asset prices; among other things, this would reduce the upfront barriers to home-ownership and increase the expected returns to the lifetime pension savings of the young; shock the home-owning middle aged who stretched themselves to buy amid the price rises of the last decade; and damage the asset wealth of those approaching, and in, retirement.

These different forces and uncertainties create flux for all parties but, when it comes to potential coalitions of support, Labour may see the case for some very cautious optimism. The nature of the inheritance of an incoming government in 2024 creates shared interests and common agendas across disparate parts of the electorate. There is now both cross-class and inter-generational support for rescuing the NHS and investment in the clean energy transition, at the same time as the Brexit divide is fading and demand for pragmatic deal-making with the EU is rising, all against the backdrop of social attitudes that, through all the noise, slowly but remorselessly continue to become more liberal. The scope to mobilise political cleavages around so-called 'culture wars' is more limited for British conservatives than for US Republicans or Central European nationalists, while progressive parties sense a stronger basis for shaping a voting bloc around a core programme of pro-growth policies, redistributive economic reform, improved public services and the Net Zero transition. This more upbeat reading of the emerging electoral landscape from a Labour perspective must be caveated, however, by the perpetually uphill struggle of building broad support for a long-termist social investment agenda.

What about the political-economic basis of support that might be marshalled by a Labour government? In recent years, textbook approaches to political economy appear to have lost some explanatory power: Brexit, and the faction of the Conservative Party that promoted it, went against the interests of key high-value export sectors, like automotive manufacturing and chemicals, and those of the City, which lost passporting rights into the EU market, as well as those of higher education and the creative industries. Meanwhile, trade unions didn't have their traditional purchase in mobilising workers in high-skilled, high-wage sectors against Brexit.[8] Instead, interests outside the productive economy – the retired population, in particular – proved critical.[9]

The post-Brexit, post-pandemic, disruption of the bedrock of the Conservative Party's electoral support has opened up possibilities for the centre left to shape a new political-economic base of support. This could combine workers in the 'everyday economy' dependent on public sector funding and procurement, like care workers, with public sector employees and so-called 'socio-cultural' professionals who commonly vote for centre-left parties; businesses and their workers in the advanced sectors of the economy, particularly in goods and service sectors that are dependent on close alignment with European markets and clean energy subsidies; and companies with a stake in regional regeneration or 'levelling up', which Labour is likely to prioritise in its green investment planning. The challenge will be to bring these disparate constituencies together with a broader cross-generational bloc of voters.

The statecraft of a new government

This analysis has implications for the priorities and statecraft of an incoming government, and particularly for the importance of making progress on urgent social needs while laying the foundations for longer-term institutional economic reforms to deliver sustained higher investment. It is going to have to deal with all this within a decidedly cramped fiscal space.

A new government will need to move at great pace while crafting a message of patience. It must rapidly rebuild strategic capacity at the heart of government. Careful thought needs to be given to public sector reform, too, setting out longer term plans for building and embedding institutions that are effective and legitimate and therefore more likely to survive a change of government. Crucially, an incoming Labour government should review the fiscal framework, with the intention of ensuring that high and stable public investment is prioritised, and is not, contrary to the practice of recent decades, the first casualty of efforts to meet fiscal rules.[10]

For policy and statecraft, we also need to broaden out from questions of the economic legacy to consider the wider 'governance inheritance'. Austerity has diminished state capacity in local government and in Whitehall itself, and the governance landscape is dramatically more complex than anything an incoming Labour government has faced before, as a result of devolution and a democratic reform process which is radically incomplete and asymmetric, particularly in England. This would require an artful approach to governing that respects the multi-national and pluralist nature of the UK, and the need to negotiate across multiple sites of powers, while also further reforming Westminster and the central state itself. If an incoming government is not to get trapped in survival mode in the House of Commons, appearing detached from the nations and the key counties and cities of England, it must navigate this new governance landscape with openness and dexterity.

How some of these inherent tensions are managed – the need to move at pace, with strong central direction, while pursuing longer-term reforms and shaping a new democratic governance – will necessarily depend on the precise outcome of a still highly uncertain election, and on whether a new government could command a stable majority or not. Different lessons on statecraft can be drawn from recent history. One option is to prosecute an agenda early and hard, as the incoming Coalition government did with austerity; another is to ride out early storms, as Margaret Thatcher's first administration did, despite waning public support; yet another is to prioritise some early results while deferring painful decisions, as Harold Wilson did in 1964, with the prospect of a second election looming. It must be remembered, too, that major capital investments take time to plan, so early clarity on how these will build up across a Parliament is imperative.

It is impossible to plan for all eventualities, not least because every government is beset by unforeseen crises of one kind or another. But preparing for the key fiscal decisions, as well as prioritising and sequencing major reforms, and having a strategy for sustaining coalitions through the inevitable strains of governing, are the *sine qua non* of success in power. As the general election nears, these tasks only become more urgent.

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Notes

1 Declinism has largely been rebutted in the work of economic historians. See Jim Tomlinson, 'Thrice denied: "declinism" as a recurrent theme in British history in the

long twentieth century', *Twentieth Century British History*, Vol 20 No 2, 2009, pp227-251.

2 The circumstances are perhaps closer to those that faced the incoming Wilson government in 1974, albeit without the decades of public and private investment and productivity growth that preceded it.

3 Torsten Bell et al, *We're Going on a Growth Hunt: Putting the Spring 2023 Budget in Context*, Resolution Foundation 2023: https://www.resolutionfoundation.org/app/uploads/2023/03/Were-going-on-a-growth-hunt.pdf.

4 Molly Broome, Adam Corlett and Greg Thwaite, *Tax Planning: How to Match Higher Taxes with Better Taxes*, Resolution Foundation 2023: https://economy2030.resolutionfoundation.org/reports/tax-planning/.

5 Eunice Goes, 'Ideas and party change: the role of predistribution in Labour's ideological renewal', *Journal of Political Ideologies*, Vol 26 No 2, 2021, pp180-200.

6 Gavin Kelly and Nick Pearce, 'Beveridge at eighty: learning the right lessons, *The Political Quarterly*, Vol 94 No 1, 2023, pp8-15.

7 British Election Study Team, 'Most volatile British electorate in modern times', 2019: https://www.britishelectionstudy.com/bes-resources/press-release-most-volatile-british-electorate-in-modern-times/.

8 Ian Fitzgerald, Ron Beadle and Kevin Rowan, 'Trade unions and the 2016 Brexit referendum', *Economic and Industrial Democracy*, Vol 43 No 1, 2022, pp388-409.

9 Joe Chrisp and Nick Pearce, *The Age Divide in British Politics*, Institute for Policy Research, 2021: https://www.bath.ac.uk/publications/the-age-divide-in-uk-politics/attachments/the-age-divide-in-uk-politics.pdf.

10 Felicia Odamtten and James Smith, *Cutting the Cuts*, Resolution Foundation 2023: https://economy2030.resolutionfoundation.org/reports/cutting-the-cuts/.