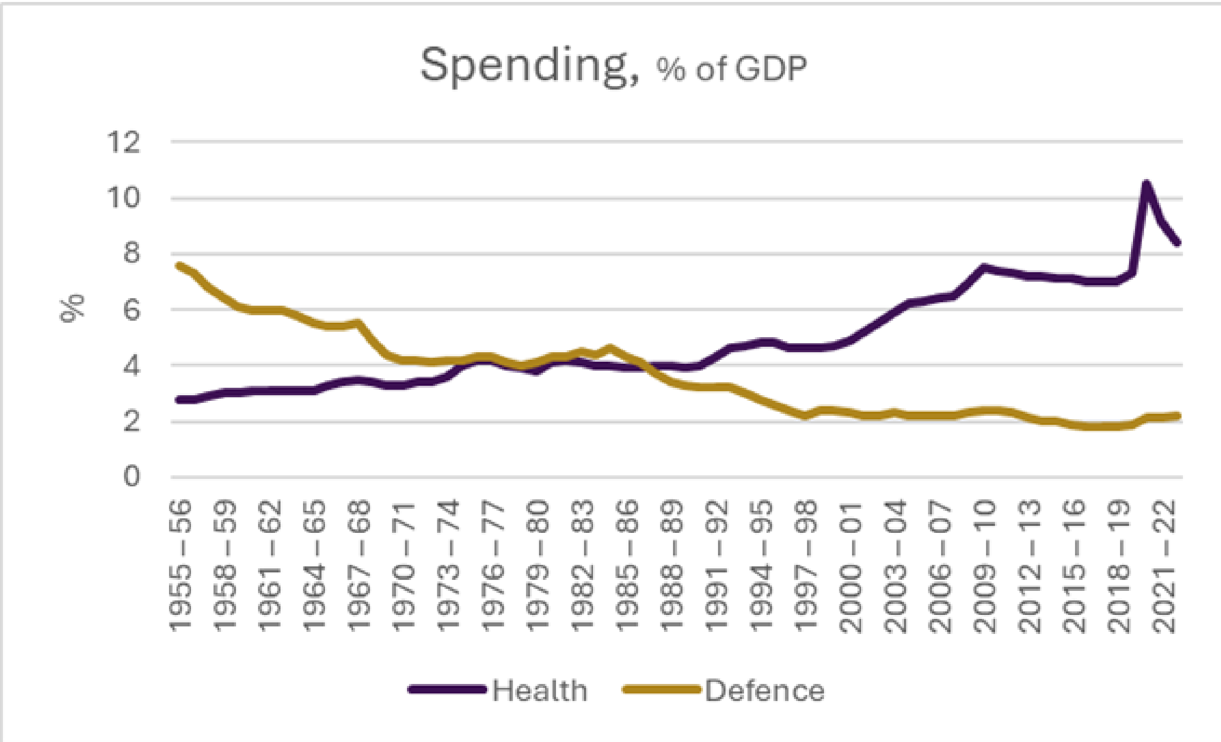
Insights, Tacit Thought | Weekly Investment Insights

Rachel Reeves: A Zugzwang Spring Statement 2025

Published on: 28 March, 2025 | Author: Investment Team

The chart below illustrates just one of the major dilemmas facing a British government of any persuasion: how to balance the inexorable rise in healthcare costs against the increasingly urgent need to bolster the defence of the realm?



Spending on health, even accounting for the squeeze on funding after 2020, is by far the largest item on the government's budget, accounting for 8.4% of GDP or 18.3% of total managed expenditure (TME). By contrast, defence spending has fallen from around 8% of GDP in 1955 to barely 2% today (troughing at 1.8% of GDP in 2016-18). Neither trend is sustainable.

The next largest items are state pensions (at 12.2% of TME) and social security/children (at 10.2% of TME). Rather ominously, the annual cost of the interest bill on the national debt at £97 billion is virtually equal to the education budget of £105 billion.

Government spending funded by tax and borrowing is already at 46.2% of GDP, the highest level since the dog days of the mid-1970s.

Thus, the UK is in danger of meeting a "zugzwang" moment – where, as per chess, any single move makes the existing position worse. Cut health to support defence and waiting lists expand, cut defence to fund housing leaves the UK vulnerable to its enemies, cut education spending to fund social care, damages the UK's capital stock of "IP" – intellectual property – on which future prosperity depends.

It is equally difficult to increase borrowing to fund spending when the UK debt to GDP is already in excess of 100% and the interest burden is rising.

This sad state of affairs can be resolved in only one of two ways, either:

1. Accept a long-run gradual decline in living standards or
2. Accelerate and reinvigorate UK productivity to generate faster growth.

It is against this last criterion that Rachel Reeves or any other Chancellor's stewardship of the economy should be judged.

In the event, the Chancellor has probably done as much as she can both to cut the welfare budget and promote investment; the latter is increased by £2bn a year and the former cut £3.4bn by 2029/30. Ms Reeves seems to have accepted that the UK tax burden is about as high as the country will bear and no tax changes have been announced. The package overall is worth £14 billion.

As a result, the Office for Budgetary Responsibility (OBR) has downgraded UK economic growth forecasts for this year to just 1% but has upgraded the following years to 1.9%, 1.8%,1.7% and 1.8% in 2029 by which time the OBR expects inflation to be at target i.e. 2%.

The two policy areas which still enjoy a cross-party omertá are European relations and the pension triple-lock. When the state pension alone costs £141 billion, the Spring statement seems very small beer.

UK investors will still have to look elsewhere to secure the kind of growth of which British politicians can only dream.

The data underpinning this note is courtesy of the Inst. for Fiscal Studies (IFS) and UK National Accoun