Ganga Shreedhar Cahal Moran November 18th, 2025

Why we are getting poorer and what the government can do about it

As Rachel Reeves gets closer to delivering her second Budget, it's becoming increasingly clear that the pre-election commitments of the Labour Government are unsustainable. ***Ganga Shreedhar*** *and* ***Cahal Moran*** *argue that Labour must reject some of the fundamental economic assumptions that have lead to the current position, and warn against an "austerity 3.0" that could further cripple the economy.*

The feeling of managed decline is palpable in the UK. The Labour Government are heading into the upcoming Budget having made a number of promises they simply cannot keep. Firstly, they have promised no increase in income taxes over their parliament. Secondly, they have imposed two fiscal rules on themselves: (1) that the budget must be balanced day-to-day (excluding investment) and (2) that public debt must be falling as a percentage of GDP by the end of this parliament.

With borrowing costs increasing to a five-year-high, they've placed themselves in an impossible situation. Something has to give. And while it seems likely that Labour will break their manifesto pledge on income taxes, and may further loosen the fiscal rules (something they already did in last year's Budget), those measures might not be enough to fund a state with increasing needs and create enough fiscal head room for unexpected economic turmoil. We find ourselves once again facing potential government cuts.

Austerity has failed

For Britons, the notion that taxes will rise while spending on, and the quality of, public services will flatline (or fall) at best is a familiar one. For both of the authors, it has been the story throughout our adult lives. Following the 2007-9 financial crash, high debts in the private sector created a perception that everyone had to tighten their belts. With public spending outstripping public revenues, this included the government. Then-Prime Minister Gordon Brown was ousted by David Cameron and the Conservatives on the grounds that they were engaging in "deficit denial". Getting the public finances in order was the priority.

Over a period of 14 years, the Conservative Government embarked on an ambitious program of fiscal adjustment, made up of austerity – tens of billions in cuts to benefits, health, education, infrastructure, and local councils. It also included tax increases, with VAT and national insurance rising. According to the Institute for Fiscal Studies (IFS), the overwhelming majority of adjustment came from spending cuts rather than tax increases and the former came to 5 per cent of GDP in total, one of the biggest fiscal adjustments in modern British history.

As a consequence, most people in the UK now struggle to get by. In 2019, the New Economics Foundation calculated that UK GDP was £100bn lower than it could have been in absence of austerity. The reason is simple: unlike a household tightening its belt, the government is a key player in the economy. Its spending can kick start (and equally, kick away) economic growth through public investment. Cutting government spending isn't just cutting public goods and services like healthcare, it means cutting employment and wages in the public sector (like the salaries of nurses.

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In 2022, the Bennett Institute at the University of Cambridge showed that "physical and social infrastructure" have declined across most English regions. Think of GP practices, mental health services, train stations, and schools. Bus routes have declined by 20 per cent across the UK as fares have gone up, making commuting and getting around harder for the poorest, who generally use buses more. Needless to say that poor health, bad schools, and insufficient transportation are not the basis for a healthy economy. This point was most dramatically demonstrated when Chancellor George Osborne's 2015 promise that we would "fix the roof while the sun was shining" later led to the collapse of an actual school roof in Kent, with schools as well as hospitals at risk across the country.

As the IFS have documented, UK investment is much lower than in other rich countries, in both the public and the private sector. GDP growth has been historically low, taking 6 years to recover from the Great Recession and only growing at a rate of one per cent per capita up until the pandemic. The IFS figure above shows that real wages dropped during the financial crisis and only returned to 2010 levels just before the covid pandemic. They are still roughly at the same level, having stagnated for a total period of time longer than any since the Napoleonic Wars.

When a government "tightens its belt" it strangles the economy – the analogy with households simply doesn't work. Unlike households, governments provide public services that are absolutely essential, as we discovered during the pandemic when essential workers kept us all going. Household spending may, at most, be planned by keeping the next generation in mind, but governments need to factor in multiple future generations and indeed the longevity and wellbeing of peoples and regions across the entire country.

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Furthermore, households don't have their own banks or their own bonds. Indeed, government borrowing underpins the entire financial system, and it's not obvious that eliminating the debt is desirable as a general rule. In her book *The Deficit Myth,* the economist Stephanie Kelton reported that when she asks US politicians if they want to eliminate their government's debt, a majority of them agree. When she asks the same politicians if they want to eliminate government bonds it elicits puzzlement, even though bonds and debt are exactly the same thing. Bonds act as a safe asset for investors and are a benchmark of the entire financial system. Households and governments are quite different.

Ending the austerity experiment

This is the background to the situation the Labour Government finds themselves in. People in the UK are worse off because of chronic underinvestment in everything from housing to small and medium enterprises. We are reaping what we've sowed.

To get out of this situation, Labour has to reject some of the assumptions that got us here in the first place: The notions that we have to balance the budget exactly over an arbitrary time period, without adding any further deficits, not matter how small, that we cannot increase taxes on the rich, that we must make further cuts to spending – these have no basis in economic reality.

In fact, cuts are often a false economy. Evidence shows that as preventative care has been cut in the UK, spending on crisis care has risen. This is why £200 million in cuts to local public health budgets cost £1 billion later on. We need to start seeing government spending as investment, money that will be saved down the road or return multiplied in the future. David Cameron's idea was to "cut the green crap", eliminating schemes for renewable energy and the retrofitting of homes. When Russia invaded Ukraine and oil and gas prices went up, these cuts ended up costing British households £150 a year in higher bills. Reviving ideas like the Green New Deal would provide the shove needed to get the country onto a better path, including by encouraging innovation in key home-sectors such as green infrastructure and technology. Instead, the government may cut green subsidies, for example to heat pumps, much like Cameron's government.

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Secondly, in many countries, interest rates are actively managed by central banks. In the UK, payments are high partly because the Bank of England had to increase rates itself to tame inflation. But this just shows the power they have, even as politicians act as if we are helpless in the face of the markets. Even during Liz Truss' disastrous budget, the markets stabilised once the Bank of

England intervened, indicating that the country as a whole can still exert power even during massive market tremors. A well-thought out plan (unlike Truss') to invest in the economy through borrowing need not frighten markets for such a large economy and financial system with a well-established currency.

Thirdly, the reluctance to tax the rich must go. Wealth inequality has skyrocketed over the past decade, just as people have struggled with the pandemic and the cost of living crisis. There are various ways to tax the wealth: a new wealth tax on their assets has become a popular idea; equalising capital gains and income tax would avoid absurdities like cleaners paying a higher rate of tax than the owner of the building they work in; finally, simply auditing the rich based on the taxes they already pay is a free lunch: in the USA, these audits returned over $12 for every $1 put into them. The economist Gabriel Zucman has some well-thought out proposals which address common fears like the wealthy simply leaving. This should be accompanied by a proper accounting of the tax avoided by the wealthy and action against evasion.

More fundamentally, instead of chasing an ethereal "economic growth" as their aim, Labour need to focus on concrete long-run human and planet-centered goals. These should include equitable access to essential goods like health, housing, transport, food, water, energy and nature, and future-proofing the UK's ability to deal with climatic shocks (e.g. droughts, flooding and extreme heat) and economic uncertainty (e.g. energy or food prices). This means building an economic system that is resilient enough to adapt to and mitigate these risks while improving peoples' lives and reducing inequality to give people a sense they aren't being ripped off. This can be done through a combination of ambitious public investment in essential sectors funded through strategic borrowing and wealth taxation. It cannot be achieved through austerity 3.0.

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About the author

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