Funding the Future

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Rachel Reeves wants growth, and it’s thought she’s going to seriously increase employers’ national insurance contributions, which is most likely to stop that happening. Why is she adopting such an absurd approach to the economy?

https://www.youtube.com/watch?v=_nLnuvsVFH0?si=QNx-Q4nSrp6XgFxl

The audio version is here:

https://www.podbean.com/player-v2/?i=5efdj-171868b-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=c73a3a&font-color=&logo_link=episode_page&btn-skin=ff6d00

This is the transcript:

A national insurance increase charged on employers could kill growth in the UK economy. Of course, that's serious because Rachel Reeves is, we understand, planning an increase in employers’ national insurance contributions in the budget that is going to be happening very soon, and that budget is supposedly all about delivering the growth that she thinks is the foundation for the economic changes that Labour is going to bring to the UK.

So, how can she do one thing - increase the national insurance, which is paid by employers - and at the same time deliver growth when the two work in direct conflict with each other? The answer is, I don't know, of course, because if my objective was growth, I would not be increasing a tax on employment.

Now, let me explain how employers’ national insurance works. Above a certain limit, an employer pays 13.8 per cent of the amount that they pay to their employee in employers’ national insurance at present. That is significantly more than the employee pays, by the way, because they're only paying 8 per cent now as a result of the cuts introduced by Jeremy Hunt, the last only in March 2024.

So, 13.8 per cent of the cost of your salary, if you have one, is, broadly speaking, going to the government in employers’ national insurance, and it is rumoured that Rachel Reeves is going to increase that by 2%, making that figure 15.8%, and that is a pretty hefty increase.

More than that, it is also suggested that she is looking at charging employers’ national insurance on the pension contributions that employers make on behalf of their employees, something that has never been done because it has been assumed that if an employer makes a pension contribution on behalf of their employee, the employee will make a smaller demand for a pension in old age, and as a consequence, the demand for benefits in the overall social security system will fall, and national insurance was once designed to contribute to social security and the NHS.

Well, that's how it works.

Now let's talk about the reality, because this might be called employers’ national insurance, but the truth is that the payment is actually suffered by the employee. Now I know it doesn't look like that, because as Rachel Reeves is relying upon, there will be no change in the employee's apparent net pay going into their pocket after the budget as a consequence of increasing this employers’ national insurance contribution. So how can I say that it is the employee who will pay this extra two percent?

The answer is quite straightforward. The evidence is overwhelming from economic studies, and in this case, I believe them, that if the employers’ national insurance contribution goes up, those employers simply resist making pay increases to the employees that they have on their books, and as a consequence, eventually the employee suffers a decline in their real wages sufficient to cover the cost of the increase in the employers’ national insurance contribution. So, in other words, it is eventually the employee who pays.

And that's what Rachel Reeves is getting wrong here. Superficially, this looks like a great move by her because it means that she can keep her manifesto commitment that she will not increase national insurance, and she didn't say she wouldn't increase employers’ national insurance, she only said she wouldn't increase workers’ taxes, and she's interpreting that as only referring to employees’ national insurance. But, if she does increase employers’ national insurance by 2%, the net effect will be that there will be downward pressure on wages, which will overall reduce them by, you've guessed it, approximately 2%.

Is that of consequence to her overall economic thinking? It's dire for it, because she says that growth is absolutely core to what she wishes to deliver. Now, assuming that she's a wise person, and she believes that growth should be perceived to exist in the pockets of those people who are going to vote for her, which is most people in the country if she's going to get back into office in 2029, of which there is no guarantee, then she will want to make sure that they feel better off as a result of that growth.

But this move will mean that they won't. Not only will they feel worse off, because there will be downward pressure on wage settlements, and that's going to be uncomfortable for her, and will lead to industrial strife, but people will actually end up feeling that they have less in their pockets. That will make them feel worse off in real terms, and it has a further consequence.

If they don't feel better off in real terms, they will, of course, not spend as much. And if they don't spend as much, the economy won't grow as much. It is something that follows like night does day. And as a consequence, what Rachel Reeves is doing is economically absurd. Crazy. A mistake. You can call it whatever you like, but it is just poor economic thinking for political expediency.

And that, in a nutshell, summarises just about everything you need to know about Rachel Reeves.