# Chancellor Rachel Reeves faces tough trade-offs as defence spending squeezes public services ahead of June review



Chancellor Rachel Reeves is poised to confront a series of daunting challenges as she gears up for the anticipated multi-year spending review, scheduled for June 11. Following the recent general election that saw the Labour Party ascend to power, concerns over their financial management are already mounting. The Institute for Fiscal Studies (IFS) has raised alarms about the government's priority to ramp up defence spending to 2.5% of GDP over the next two years. This approach not only underscores the Labour government’s failure to address pressing domestic issues but also severely constrains the budget for essential sectors such as healthcare, public services, and environmental initiatives.

The IFS has cautioned that the government's financial landscape will be increasingly austere compared to prior years. After a brief period of increased spending, it is evident that the flow of funds is set to dwindle. Research economist Bee Boileau has warned that with most resources likely diverted to defence, it will be "impossible" for the government to also invest in crucial net-zero initiatives or foster economic growth. This alarming trend paints a grim picture for Reeves as she struggles to allocate shrinking funds to public services that are already stretched thin, particularly as the NHS continues to grapple with overwhelming backlogs exacerbated by the pandemic.

Complicating matters for the newly installed government is the internal discord brewing within the Labour Party, particularly between Reeves and Deputy Prime Minister Angela Rayner. Reports indicate a standoff over budget allocations, with Rayner's Ministry of Housing yet to secure a budget agreement. This impasse poses significant risks to council funding, amplifying the warning from the Local Government Association about a projected funding gap of up to £8 billion by 2028/29. Without a substantial and sustained influx of funding, local authorities are ill-equipped to provide essential services, a situation that could worsen under Labour's mismanagement.

Critics from opposition parties are rightfully amplifying their demands for increased investment in social care. The De facto neglect of social care resources could prove catastrophic for the NHS, which is already struggling to deal with its own issues. Daisy Cooper, Treasury spokeswoman for the Liberal Democrats, has explicitly stated that without addressing the social care funding crisis, efforts to resolve NHS challenges may be futile, further burdening an already overextended healthcare system.

On a broader front, the International Monetary Fund (IMF) has highlighted a need for strategic adjustments, advising Reeves to simplify her fiscal policies. The IMF’s suggestions, including an annual assessment by the Office for Budget Responsibility (OBR) to ensure fiscal stability, indicate that Reeves' current strategy—targeting a balanced budget by 2029-30—is precariously dependent on economic conditions. The prior commitments made under Rishi Sunak’s administration, combined with ongoing inflationary pressures, only amplify the urgency of this situation.

Amid soaring gilt yields and a bond market sell-off, concerns over the UK's fiscal health are intensifying, placing unprecedented pressure on the Chancellor. Analysts are warning of a potential credibility crisis stemming from fiscal mismanagement, compelling the government to tread carefully to maintain public confidence. The spectre of significant cuts to "unprotected" sectors such as justice and policing looms ominously as Reeves contemplates taxing the public further or revisiting her defence spending strategy.

Ultimately, the impending spending review is a critical inflection point for the Labour government. As it attempts to juggle competing demands across multiple departments, the delicate balance between defence spending, public investment, and social care will shape the UK’s economic landscape for years to come. The decisions made in this review are not just a reflection of current priorities; they risk dictating the long-term fiscal health and sustainability of vital public services.

Source: [Noah Wire Services](https://www.noahwire.com)

## Bibliography

1. <https://www.independent.co.uk/news/uk/politics/rachel-reeves-ifs-economy-net-zero-b2761308.html> - Please view link - unable to able to access data
2. <https://www.reuters.com/world/uk/uk-faces-choice-next-week-between-health-other-spending-ifs-think-tank-warns-2025-05-31/> - The UK's upcoming multi-year spending review, set to be unveiled by Finance Minister Rachel Reeves on June 11, poses a critical decision for the Labour government on how to balance funding between healthcare and other public services. The Institute for Fiscal Studies (IFS) highlights the challenge, warning that Prime Minister Keir Starmer’s prior commitment to increase defense spending to 2.5% of national income by 2027 has constrained room for further public investment. Under current plans, non-investment public spending is set to rise 1.2% annually above inflation from 2026–2029—a pace slower than previous years. Given pressing demands on the NHS, which is struggling with long wait times and reduced productivity post-COVID, Reeves may be forced to prioritize between healthcare expansion and maintaining service levels in other departments. Higher healthcare spending could result in 1% annual cuts in other sectors. The IFS argues that without clear plans for managing cuts—such as service reductions, public sector employment cuts, or pay freezes—the government risks undermining financial market confidence. This review, the first comprehensive multi-year plan since 2015, is seen as a pivotal policy moment for the Labour administration.
3. <https://www.ft.com/content/8135f7d3-8328-47fa-9dfc-23c055605796> - UK Chancellor Rachel Reeves is facing growing fiscal pressure due to a global bond market sell-off driven by concerns over US debt and rising yields in global markets. UK 30-year gilt yields have surged to their highest levels in 27 years, while 10-year yields have increased more than most other G7 nations, reflecting worries over the UK’s fiscal resilience and persistent inflation. With slow economic growth and limited fiscal headroom of just £9.9bn, Reeves is under pressure to either reduce public spending or increase taxes to meet her target of balancing day-to-day spending by 2029-30. Political demands to reverse planned savings and expand benefits are straining her strategy, while global demands for increased defense spending add further complications. Analysts warn that the strict fiscal rules Reeves imposed may be counterproductive, risking credibility and potential downgrades by the Office for Budget Responsibility if productivity forecasts fall. The Bank of England’s ongoing bond selling program and market memories of the 2022 mini-budget mishap add to the risks. The Treasury insists its fiscal rules are vital for ensuring economic stability, though outside experts doubt whether current policies are sustainable without further tightening or significant economic improvements.
4. <https://www.ft.com/content/82eb9647-aab2-47d1-8eec-fb103544277a> - The International Monetary Fund (IMF) has offered UK Chancellor Rachel Reeves political backing to potentially revise the country’s fiscal framework, suggesting a shift to a single annual assessment by the Office for Budget Responsibility (OBR) to promote policy stability. Reeves’ current fiscal strategy mandates balancing day-to-day spending with revenues by 2029-30, but her fiscal headroom—currently £9.9bn—is minimal and vulnerable to economic fluctuations. The IMF’s latest report highlights that small forecast adjustments can force frequent policy changes, urging structural reforms and the adoption of mechanisms to manage minor fiscal breaches without overreaction. Though the IMF deemed Reeves' spending plans "credible and growth-friendly," it noted the limited fiscal space could necessitate tax hikes or spending cuts if external shocks occur. Growth forecasts for the UK were marginally raised to 1.2% in 2025, but medium-term prospects remain subdued at 1.4%, constrained by weak productivity. The IMF also warned about risks from global trade tensions and rising borrowing costs, which have reduced fiscal flexibility. Ahead of the upcoming Spending Review, Reeves faces pressure to manage public finances while addressing long-term challenges like an aging population and ensuring sustainable economic growth.
5. <https://www.ft.com/content/664b284e-08c8-4201-bd42-7e961e24d210> - UK Chancellor Rachel Reeves is considering options to increase Britain's military budget, responding to pressures from US President Donald Trump and changing global security dynamics. British defence spending is currently 2.3% of GDP, and PM Sir Keir Starmer has proposed raising it to 2.5%. Defence chiefs seek a higher target of 2.65%, which would add £10bn annually, a proposal not yet backed by Downing Street. Reeves can either revise fiscal rules, which currently aim to balance the budget by 2029-30, cut spending in "unprotected" public sectors like policing and justice, delay the spending increase until after the next general election, or raise taxes. A proposed tax strategy includes extending the freeze on income tax thresholds and allowances. Additionally, innovative funding solutions such as creating new multilateral financing institutions or a "rearmament bank" are being considered. These institutions would require significant support from international allies.
6. <https://www.ft.com/content/1f3a61e2-7e9e-43c7-8d43-d553744ecb7c> - Chancellor Rachel Reeves faces criticism within the Labour Party over last-minute welfare cuts aimed at addressing a £15bn fiscal gap ahead of her Spring Statement. Initial claims by Secretary Liz Kendall that welfare reforms would save £5bn annually were contested by the Office for Budget Responsibility (OBR), which estimated only £2.9bn in savings. In response, the government implemented an extra £500mn in cuts, including freezing universal credit incapacity benefits for new claimants until 2030. These discrepancies have caused internal discontent and raised concerns over the government's fiscal planning. The OBR is also expected to halve the 2025 growth forecast from 2% to 1%, compounding the bleak economic outlook. To offset the shortfall, Reeves announced further public spending cuts and a £2.2bn increase in defence spending, partially financed by reductions in overseas aid. Reeves aims to project economic and military security, citing global uncertainties such as Donald Trump's return to the presidency. While officials resist claims of renewed austerity, slow growth and global trade tensions may necessitate more cuts or tax hikes in future budgets. Public confidence in Reeves remains low, with only 11% of surveyed voters viewing her economic management positively.
7. <https://www.reuters.com/world/uk/uks-reeves-announces-budget-update-parliament-2025-03-26/> - British finance minister Rachel Reeves presented her budget update to parliament, addressing various key issues in response to global economic uncertainty. Reeves emphasized that fiscal rules remain non-negotiable to ensure economic stability and confirmed no further tax increases. She announced an increase in capital spending by 2 billion pounds annually to drive growth and fulfill defense commitments. Day-to-day spending will be reduced by 6.1 billion pounds by 2029-30, growing at a slower rate than previously projected. The welfare budget package is estimated to save 4.8 billion pounds, with investments in personalized employment support and the Department for Work and Pensions. Defense spending will focus on novel technologies, and a new Defence Growth Board will be established. Housebuilding is expected to reach a 40-year high, with significant reforms aiding construction. Inflation is forecasted to stabilize, providing economic security. Public services will benefit from 3.25 billion pounds in investment to reduce operational costs. Living standards are expected to rise, and efforts to combat tax evasion will raise additional revenue.