



Brown's second spending spree to reach 50% of GDP – and it's not because of the recession

New report calls for Emergency Budget and a spending freeze

Government spending is growing far more quickly than in other countries, and faster than in previous recessions, think tank Policy Exchange today warns. A new report finds that the surge in spending is not being driven by the recession. At most, 6% of the increased spending is going on public works, and just over a third is due to the rising cost of social security or debt. Instead of "investment", most of the increase is due to a decision to spend more on *consumption*.

Controlling public spending: the scale of the challenge argues that whoever wins the next election should introduce an Emergency Budget. Just calling off those spending increases which are not related to the recession after April 2010 would save £21.6 billion. The report also argues that all budgets except Social Security, Tax Credits and debt interest could be frozen at 2008/9 levels – resulting in savings of £87 billion on the Government's current plans.

Andrew Lilico, Policy Exchange's Chief Economist and author of the report, said:

"Brown's spending spree is even bigger than the splurge that led to the 1976 IMF bail-out. Spending in Britain is rising twice as fast as it in France, but most of the increased spending here has nothing to do with combating the recession.

"The Government is already planning to raise tax for everyone earning over £20,000 a year through increased National Insurance contributions, and we are borrowing a record £175 billion a year. Yet we are being taken ever deeper into debt. The Government admits that the public finances will have to be put back onto a sustainable footing after the election, so why splurge next year, only to have to cut back harder later?"

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Notes to Editors

There have been two separate surges in spending under Gordon Brown: the first rise took spending from of 36.3% of GDP in 1999/2000, to 41.3% by 2005/6. Arguably this is what the Government had been elected in 1997 to do. Spending then stabilised – remaining at 41% of GDP until 2007/8. But since then an unprecedented second surge has begun. In 2008/9 public spending rose to above 43% of GDP. The 2009 Budget envisages spending rising to 47.5% of GDP in 2009/10 and the 48.1% in 2010/11 – a rise of more than 7% of GDP in just three years.

Even this is based on rosy assumptions— spending is likely hit a record of over 50% of GDP. The Budget’s forecasts for public spending as a share of the economy are based upon highly optimistic forecasts about growth. For example, the IMF thinks that by 2010 the UK economy will be 2.2% smaller than the Treasury thinks. Taking just this difference in growth, that implies 2010/11 spending of 49.2% of GDP. That’s a rise of 8.2% in just three years - larger even than the wild rises of the 1970s. That would bring the total spending increase since 1999 to a stunning 12.9%. The European Commission also predicts a bigger increase than the Treasury. It forecasts that its (rather broader) measure of public spending will rise from 44% of GDP in 2007 to 52.4% of GDP in 2010 – a rise of 8.4% over three years, and an increase of 13.2% since 1999. The further out the projection, the more rosy the Treasury forecast looks: e.g. the independent forecasters surveyed by the Treasury think that by 2011 the economy will be 3% smaller than the Treasury estimates.

The second surge in spending is huge - in both historic and international context. The surge in public spending is much bigger than during the last two recessions. It is even bigger than the loss of control which led to the IMF bail-out in 1976. Compared to other countries, our public spending rise is bigger - despite similar or worse economic problems elsewhere.

Table 1a: Historic rises in spending (% of GDP)		Table 1b: Rise in spending 2007-2010 (% of GDP)		Average growth 2007-2010
1972/3 - 1975/6	7.8	UK	8.4	0
1979/80 - 1982/3	3.5	USA	6.4	0.3
1988/9 - 1992/3	4.8	Euro area	4.9	-0.2
1999/2000 - 2005/6	5.0	Germany	4.8	-0.3
2007/8 - 2010/11 (Budget spending and growth)	7.1	France	4.1	-0.1
2007/8 - 2010/11 (Budget spending, IMF growth)	8.2	Italy	3.2	-0.9
2007 - 2010 (European Commission)	8.4			

Only a third of the second surge in spending is the result of the recession – most simply reflects a choice to increase Government consumption spending. Between 2007/8 and 2010/11 spending is forecast to rise by £119 billion. But little more than a third (38%) of this increase in spending reflects the costs of the recession – like rising social security bills, and higher debt interest. None of the cost of the banking bailout is included in the total. About 6% of the increase is related to an increase in capital spending – which you *could* argue is a sort of Keynesian “public works” programme. That still leaves 56%, over half of this increased expenditure, which is the result of chosen increases in consumption expenditure. £19 billion of this is current spending on the NHS, £9 billion is Education and £41 billion goes to other departments.

Why splurge next year, only to cut back? Given that the Treasury argues the UK will have started growing by late 2009, and that most of the spending has nothing to do with combating the recession, it’s difficult to see the case for continuing to increase spending into 2011. In fact the 2009 Budget acknowledges that the increase will be swiftly followed by cuts after the election: between 2010/11 and 2013/14 public spending will be cut by 2.5% of GDP, then there will be a further tightening (either spending cuts or tax rises) of 3.5% of GDP in the years to 2017/18.

There should be an emergency budget after the next general election to call off the planned increase in spending. It is much easier not to raise spending than it is to cut it later. The next general election must be held by 3 June 2010, but is likely to be earlier. If we just abandoned the discretionary increases

in consumption spending (i.e. still allowing social security etc to rise) between this financial year (April 2009/10) and the financial year (April 2010/11) we would save £21.6 billion in the first year. If, instead, 2008/9 formed the base, the savings in the first year would exceed £50 billion.

Higher spending will reduce the rate of growth: An ECB study by Afonso & Furceri (2008) found that *“a percentage point increase in the share of total revenue (total expenditure) would decrease output by 0.12 and 0.13 percentage points respectively for the OECD and for the EU countries”* –Mo (2007) writing in Fiscal Studies finds an even higher figure: *“a 1 percentage point increase in the share of government consumption in GDP reduces the equilibrium GDP growth rate by 0.216 percentage points”*. In other words, a 10% GDP rise in spending could cut growth by 1-2% a year.

The risk of a crisis is rising: the 2009 Budget predicts record borrowing: 12% of GDP (£175 billion a year) and a doubling of the national debt. Many analysts think even this is too optimistic and Standard and Poor’s have already warned that the UK’s credit rating may be downgraded, which could spark a vicious circle of rising borrowing costs and higher borrowing. If we do not think that the UK will return to strong growth, and we think that oversized public spending will hold back growth, then it is essential to put the public finances back on a sustainable footing more quickly. The best place to start is by cancelling the planned rise in discretionary government consumption spending.

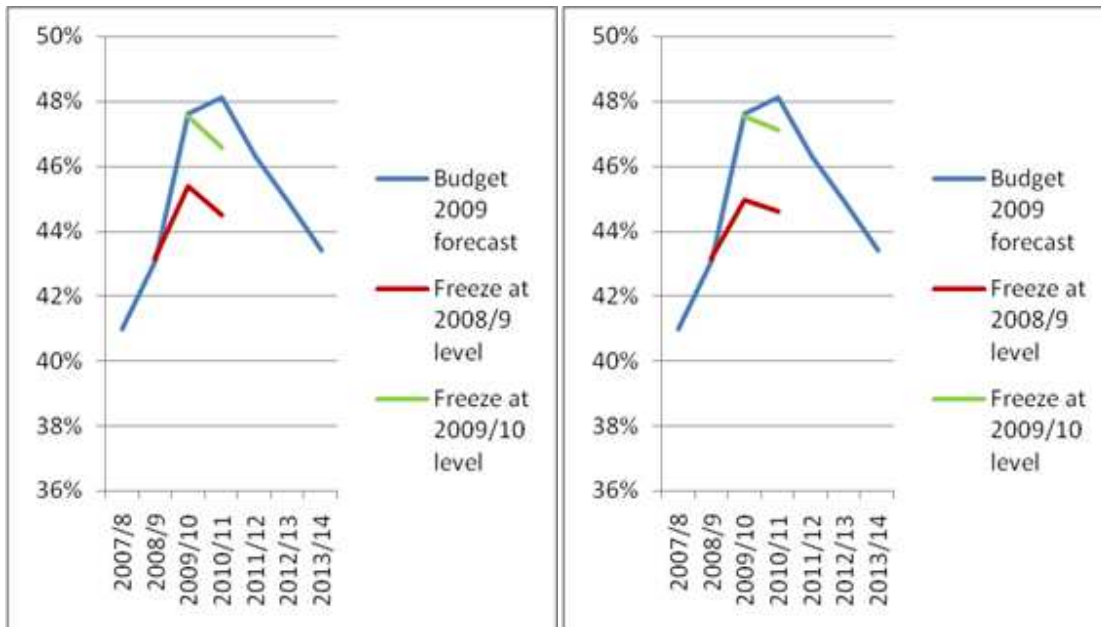
We are unlikely to tax our way back to stability. The Government has already announced that it will increase tax for everyone earning more than £20,000 a year by raising NI contributions. The Treasury thinks a 1p increase in the basic rate of tax raises about £4 to £5 billion, so trying to fix the £175 billion a year deficit without controlling spending would require absurdly high tax rates.

So why put off until tomorrow what needs to be done today? The effect of freezing spending on everything other than social security, tax credits debt interest and capital is simply to move us more quickly towards fiscal stability. ***It would not represent a spending “cut”, but instead a choice not to increase discretionary spending which has nothing to do with the recession.*** It would simply accelerate the slowdown in spending which the Government itself acknowledges needs to happen.

Figure 1: Total Managed Expenditure as % of GDP

Freezing budgets except Social Security, Tax Credits, debt interest and capital spending

Freezing budgets except Social Security, Tax Credits, debt interest



A full copy of *Controlling Public Spending: the scale of the challenge* is attached

Freezing all budgets except Social Security, Tax Credits and debt interest – see page 17, *Controlling public spending*.

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