

Parties join the fight for the tax and spending spoils

Three weeks down, thirty to go! After the political party conferences now it is time for the run-up to the General Election, which is widely expected to be held at the last minute next May. That would coincide with the eighteenth anniversary of Lady Thatcher's election victory on 3 May 1979.

After eighteen years, will the Tories come of age, winning another term, or will the voters opt for the new, in the form of Labour? Labour's opinion poll lead suggests they will win. But the closer to the election, the narrower the lead could become, as economic recovery boosts the Government's popularity and Labour's policies are put under an intense spotlight.

What are we to make of the economic policies on offer? Despite their desire to sound different, the Conservatives and Labour have similar economic policies. This merging of economic policies is not unique to Britain. Following the inflationary 1970s there has been a wide adoption of anti-inflationary policies throughout the industrialised world. Political parties of the Left and Right have pursued low inflation objectives, with more power and

independence given to central banks. The Tories and Labour are offering a similar cocktail of tight budgets, tax cuts and low inflation. How credible is this? Clearly the deeper one digs the greater the possible differences, on issues such as the social budget, minimum wages and attitude towards Europe, but let's stick with fiscal policy, central to the election campaign.

It is remarkable that after 17 years of Conservative rule, the Labour Party is not prepared to fight the election on a more aggressive economic agenda. Even though Gordon Brown has correctly identified low investment as one of the economy's underlying problems there is no sign that he is able or willing directly to do something about this.

Brown's conference speech even used Thatcher's words to say there was no alternative to his tough budget strategy. Brown is clearly trying to ease fears over Labour's spending plans. He genuinely wants to be tough, realising that Labour has to shed its image as a tax-and-spend party. It can only do that in Government.

But if Labour wins the election, it is a policy that may be difficult to keep. To be

elected Labour has to continue to woo the floating voter. Once elected it aims to win over the financial markets by being tough on spending. The trouble is that at some stage it may need to appeal to the expectations of its own voters, which is for higher spending on public-sector services and wages.

But there has already been a phenomenal increase in spending by this Government over the years. Hence they are now in the position where they are trying to curb public spending, even in the run-up to the election. Normally governments try to boost spending ahead of polling day.

Unfortunately you can only do that if your finances are in a position of strength. And clearly the Government's finances are not. This is partly the legacy of sterling's ERM days, when growth suffered, but it also reflects an inability to control overall spending.

The Government has aimed to reduce public spending to less than 40% of national income. In the last fiscal year, the figure was 42.25% but there has been an erratic path, from a peak of 47.25% in 1975 under the last Labour Government to a temporary low of 38% during the Lawson Boom.

Throughout the industrialised world higher pension and health-care costs have boosted debt-to-GDP ratios. The UK is no different. Three main areas account for almost two-thirds of UK public spending: social security, health and education. Their share continues to grow.

One-tenth of the £90 billion annual social security budget is for the unemployed. Almost half of it is for pensions, despite the low level of pensions compared with the rest of Europe. Opinion polls show that the public believes more money should be spent on health and education.

Many people may be shocked by how much already is. In real terms, after adjusting for the impact of inflation, there has been a rise of over two-thirds in spending on the health service since the Conservatives came to power. It now accounts for 16% of government spending. There has also been a dramatic rise in education spending, which has risen by one-third in real terms, accounting for 12% of government spending.

The Conservatives and Labour are telling only half the story. If the Tories want to cut taxes they will have to cut spending. This will

be difficult as demand for public services grow. So far, the Government has taken the easy option, curbing government investment, whilst leaving untouched the social security budget. Labour, meanwhile, may even find it difficult to match people's expectations, without higher taxes.

The ideal solution to the budget issue is strong, sustained economic growth. How can a government sustain higher growth, boosting prosperity, generating jobs and curbing spending? After all, Britain's trend growth rate has been consistent at 2% per year for over a generation.

A successful government should gear policy to a flexible labour market and encouraging greater investment in value-added areas of the economy, whether it be manufacturing or services.

With stronger sustained growth, decisions on public spending may be less painful. If not, then tough choices will be needed and this is where the real differences between the parties may be evident.

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Tough choices will need to be made on spending or taxes, whoever wins the election, says Gerard Lyons

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