National Institute of Economic and Social Research

Press Release

National Institute of Economic and Social Research

Tax and spend pledges to deliver bigger state but only little impact on growth

FOR IMMEDIATE RELEASE

With the economy operating near production capacity, the main impact of the tax and spending policies proposed in the main political parties' manifestos is to shift resources from the private sector to the public sector, giving only a small boost to overall economic growth according to an election briefing by the National Institute of Social and Economic Research (NIESR).

Labour policies are estimated to increase GDP by 0.4 per cent annually over the five years of the news parliament, simulations of its spending, investment and taxation proposed by NIESR's National Institute Global Economic Model (NiGEM), show. With the economy operating close to its productive capacity, tax and spending plans set out by the Labour Party squeeze the size of private sector investment by 1.3 per cent of GDP, net exports by 1.3 per cent of GDP and private consumption by 1 per cent of GDP, offset by an increase in the size of government by 4 ½ per cent of GDP. This does not account for nationalisation plans which would further reallocate private sector demand to the public sector.

The Conservative manifesto contains only modest current expenditure and tax measures in addition to plans set out for the 2020-21 financial year in the 2019 Spending Round. While most of the planned capital expenditure will still have to be allocated to specific projects, it is estimated to raise GDP by 0.2 per cent over 2020-24. This would increase the size of government by 1 per cent of GDP while reducing the private sector component in aggregate demand by 0.7 per cent of GDP. Liberal Democrat proposals are skewed towards higher investment spending, raising GDP by 0.3 per cent over 2020-24.

"*Overall, the impact on overall economic activity of tax and spending measures will be small,"* said Garry Young, Director of Macroeconomic Modelling and Forecasting at NIESR. "*All parties' plans involve a reallocation of resources from the private sector to the public sector, which is substantially larger for Labour and Liberal Democrat plans compared to Conservative proposals. While higher public spending and investment increase the share of the government in the economy, a higher interest rate and exchange rate make private sector investments more costly and exports less profitable. But the macroeconomic impact of the parties' tax and spending proposals largely depends on the response of the Bank of England's Monetary Policy Committee and market expectations of future interest rates."*

- With the economy operating near production capacity, the main impact of tax and spending policies is to shift resources from the private sector to the public sector, particularly in the case of the Labour Party and Liberal Democrat policies. The effect on aggregate output is small and estimated to boost GDP annually by 0.2 per cent (Conservative Party) to 0.4 per cent (Labour Party, Liberal Democrats) over the next Parliament, 2020-24.

- The economic impact of different parties' plans depends crucially on the outcome of Brexit. Even combined with the proposed fiscal stimulus, a UK-EU free trade agreement or customs union would leave GDP smaller than it would have been with continued EU membership.
- The economic impact of proposed fiscal policies also depends on the response of monetary policy and inflation expectations. If there were more economic slack, the proposed policies would provide a larger boost to economic activity (adding 3½ per cent to GDP over 2020-24).
- Economic policies beyond tax and spending are likely to have important implications for future economic prosperity but these will depend on how those policies are implemented.

ENDS

Notes for editors:

This full General Election Briefing on "The Macroeconomics of Parties' Tax and Spending Plans" can be found ***here***.

NIESR's microsite containing briefings, podcasts and vodcasts on the General Election can be found ***here***.

This briefing is supported by the Nuffield Foundation.

For further information or to arrange interviews, please contact the NIESR Press Office: Luca Pieri on l.pieri@niesr.ac.uk 0207 654 1931 / 079 305 44631

Further details of NIESR's activities can be seen on http://www.niesr.ac.uk or by contacting enquiries@niesr.ac.uk Switchboard Telephone Number: +44 (0) 207 222 7665

National Institute of Economic and Social Research

Nuffield Foundation