The Stock Market under Labour

The legacy of Gordon Brown

JOHN LITTLEWOOD

Centre for Policy Studies

The Stock Market under Labour

The legacy of Gordon Brown

JOHN LITTLEWOOD

THE AUTHOR

John Littlewood is a graduate of New College, Oxford. He enjoyed a City career of 32 years, as an investment analyst and later in a senior management role. He was a Partner in stockbrokers Rowe & Pitman and later a Group Director at S G Warburg. He is the author of a history of the post-war London stock market, *The Stock Market: 50 years of capitalism at work* (Financial Times Pitman Publishing, 1998); *Labour and the Stock Market: is New Labour really any different?* (Centre for Policy Studies, 2002); and *The Stock under Labour: for New read Old* (CPS, 2004).

The aim of the Centre for Policy Studies is to develop and promote policies that provide freedom and encouragement for individuals to pursue the aspirations they have for themselves and their families, within the security and obligations of a stable and law-abiding nation. The views expressed in our publications are, however, the sole responsibility of the authors. Contributions are chosen for their value in informing public debate and should not be taken as representing a corporate view of the CPS or of its Directors. The CPS values its independence and does not carry on activities with the intention of affecting public support for any registered political party or for candidates at election, or to influence voters in a referendum.

ISBN 978-1-905389-91-9

Printed by 4 Print, 138 Molesey Avenue, Surrey

CONTENTS

FOREWORD

This publication, the latest in a series on the causes and implications of the economic crisis from the Centre for Policy Studies, examines how, in comparison to almost all other leading economies, the UK stock market has performed appallingly over the last twelve years.

John Littlewood examines the policy decisions made by Gordon Brown, both as Chancellor of the Exchequer and Prime Minister, and reveals how they have created unsustainable government deficits, undermined UK competitiveness, allowed asset bubbles to develop and permitted irresponsible risk-taking by banks to go unchecked. The prognosis is dismal.

Of course, the stock market is not only an excellent barometer of economic health. It is also an important engine of wealth (and, in turn, of tax revenue). And its performance has a direct impact on the health of private pension schemes. As John Littlewood makes clear, the stock market matters to all of us.

At the Centre for Policy Studies, we are combining our analysis of the present crisis with an examination of what should be done next – not just to prevent the worst case scenario, but to help restore British competitiveness in the longer term.

Earlier this year we published *What Killed Capitalism?* by Andrew Lilico, which examined the banking crisis and presented an alternative scenario to the Government's mishandling of the bank bail-out. The publication emphasised the need for bondholders in banks to bear some of the risk and taxpayers less. In the long term, Andrew argued for a re-examination of deposit insurance, and clarification that depositors are preferred creditors.

We have also recently published on the state of the UK public finances and the cuts in spending needed to bring us back to a level of debt that is sustainable, and on home repossessions. Later this year we will be reporting on financial regulation, examining changes made to the role of the Bank of England and considering how best to provide for prudential oversight of the banking system. Equally important will be reform to the misguided inflation targets imposed on the Bank of England – the root cause of many of the economic problems the country faces today.

There is an alternative to greater regulation, higher taxes, declining competitiveness and economic decline. The Centre is committed to advocating the policies which will lead once again to an economy that is competitive productive and innovative.

Jill Kirby
Director
Centre for Policy Studies
May 2009

SUMMARY

- The London stock market has always performed poorly under Labour Governments, with equity indices failing to match inflation, let alone participating in economic growth.

- Its performance under this Labour Government has been even worse than during previous Labour governments. Inflation since May 1997 has been 23% (CPI) or 35% (RPI). The FTSE100 index has fallen by 9%.

- The London stock market has been outperformed by all other major stock markets with the exception of Japan. The recent devaluation of sterling has made these comparisons significantly worse.

- Government expenditure has risen from 40.6% to 45.4% of GDP since 1997 and is now higher than in Germany.

- Regulations imposed on business since 1997 are estimated to have cost £77 billion.

- Since 1997 the ranking of the United Kingdom in each of the three main international league tables of world competitiveness has steadily fallen.

- In 1997, Gordon Brown benefited from a golden inheritance. In 2007, he passed on to his successor a poisoned chalice.

- In his first term as Chancellor, Gordon Brown consistently underestimated the strength of the economy. In his second and third terms he launched "tax and spend" policies that have led to government borrowing averaging £35 billion in each of the last six years.

- During his period as Chancellor, the savings ratio fell from 10% to zero and the current account of the balance of payments rose from a near balance to a deficit of 3.6% of GDP.

- The Government has presided over a pensions crisis for private sector employees. The removal of tax credits in 1997 has directly contributed to the closure to new entrants of most final salary pension schemes. Unfunded public sector pensions continue to be a huge potential burden on the economy.

- The creation of the Financial Services Authority in 1997 to take away from the Bank of England responsibility for the regulation of banks has been a failure.

- "No more boom and bust" was last cited by Gordon Brown in his March 2007 Budget. Six months later, Northern Rock collapsed.

- The combination of chronic government deficits prior to the recession, massive spending on the rescue of the banks, the cost of the financial stimulus and the dependence of the economy on a strong but now badly wounded financial sector, means that the prospects for the economy and the stock market are bleak.

1. THE STOCK MARKET SINCE 1 MAY 1997

During all the periods in office of Labour Governments since the War, equity shares have performed poorly. This happened in 1945-51, 1964-70 and 1974-79 when indices showed losses of 8%, 13% and 11% respectively after adjusting for inflation. Despite expectations that in 1997 it would be different, the 12 years since then have so far produced a much worse performance than any of the previous three Labour Governments. Under New Labour losses now extend to 26% in real terms.

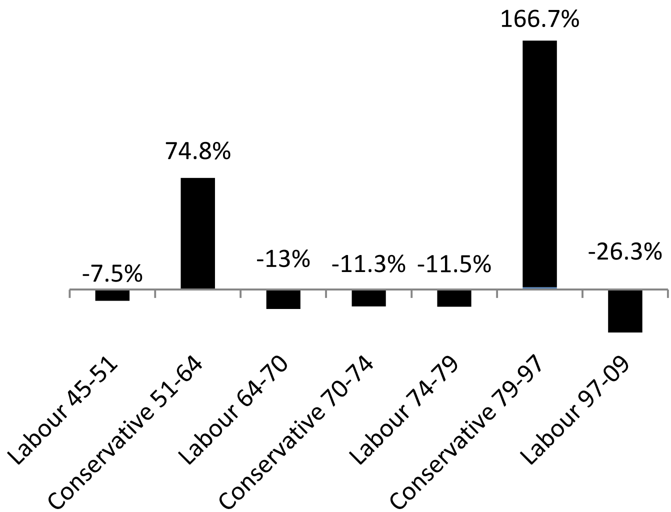
In contrast, the three periods in office under the Conservatives witnessed two long eras of outstanding stock market returns, 1951-64 and 1979-97; and one shorter period, 1970-74, that fared equally as poorly as Labour.

A healthy stock market is important. The stronger the economy, the higher the profits; the higher the profits, the higher the stock market; the higher the stock market, the greater the wealth. It is a virtuous circle producing benefits to be widely shared. Governments receive higher and at times effortlessly growing revenues. Increasing share prices benefit the pension funds, life assurance companies and unit trusts that harness the savings of millions of people. Private shareholders build an asset base that generates extra consumer confidence that in turn adds to the buoyancy of the economy. Governments and companies enjoy a cheaper cost of capital.

The stock market matters. Its direction is primarily driven by the consequences of political and economic decisions taken by Governments. Rarely has this been more apposite than over the last year. Since reaching a high of 6376 in May 2008, the FTSE100 has fallen by 37% to 4030 and sterling has fallen by some 20% to 25% against major currencies. This collapse in the value of personal assets will adversely affect consumer spending and will have a devastating effect on the assets of pension funds, particularly for the millions who have been driven out of final salary pension schemes into self-invested defined contribution schemes.

The following chart shows the capital changes of equity indices in the London stock market under successive governments, in real terms. Performance is defined by taking the changes of relevant stock market indices during these periods in office and, to give a real return, adjusting them for inflation over the same period. Note that for the current period in office the Consumer Price Index (CPI) is used; and that if the Retail Price Index was used, the performance would have been even worse (at minus 32.8%). The details of the calculations are shown in Appendix One.

Real Stock Market returns



The mood of the stock market was relaxed about the election victory of New Labour in 1997. Tony Blair had successfully persuaded investors that he had abandoned nationalisation, distanced himself from the trade unions and accepted many of the Thatcher reforms. This air of calm was helped by two particular decisions. These were the manifesto commitment not to increase the standard and maximum rates of income tax; and the immediate and surprise handing over of responsibility for setting interest rates to an independent Monetary Policy Committee chaired by the Governor of the Bank of England. Here was a New Labour government that was, apparently, not looking to finance tax and spend policies, did not seek a command and control economy, would not interfere in the management of monetary policy and would, above all, prove its ability to manage the economy responsibly and successfully.

The stock market was so at ease about an imminent Labour government that the FTSE 100 Index reached a new all-time high on the day of the General Election and for the next two and a half years continued to surge ahead through to December 1999. And yet, despite this strong beginning, the performance of the stock market over the last 12 years has been significantly worse than under any previous post-war government.

Two important reasons for investing in equity shares are to participate in the growth of the economy and to seek protection from inflation. It is extraordinary that after 12 years of economic growth of around 36% and RPI inflation of around 35%, the FTSE 100 index is today 9% lower than it was in May 1997.

Returns have obviously been badly affected by the worldwide collapse in share prices since September 2008, but what makes the record during the Blair/Brown era worse is the extent to which local investors in most comparable developed countries have achieved better returns over the same period. Japan has been a singular exception and the United States has performed much the same as the UK. However, the comparisons are made strikingly worse if the devaluation of sterling is taken into account.

The following table shows the percentage changes in the various indices in (a) for the local investor and (b) for the sterling investor. The strongest performers for local investors have been the three countries showing the strongest economic growth – Spain, Australia and Canada. Much the weakest performer has been Japan, with modest growth and still suffering from the deflationary consequences of the bursting of a massive asset bubble in 1989.

UK Stock Market performance compared with other indices since 1 May 1997[1]

	1 May 1997	22 April 2009	% change (a)	% change (b)
UK FTSE 100	4,445.0	4,030.7	(9.3)	(9.3)
US S&P 500	939.77	843.5	(10.2)	1.0
France CAC 40	2,639.46	3,025.2	14.6	47.3
Germany DAX	3,438.07	4,594.4	33.6	70.6
Italy S&P Mibtel General	12,216.0	14,369.0	17.6	50.2
Spain Madrid SE	513.35	923.6	79.9	128.1
Australia S&P All Ord	2,488.0	3,627.2	45.8	47.9
Canada S&P Composite	5,976.6	9,279.2	55.3	96.9
Japan Nikkei 225	19,151.12	8,727.3	(54.4)	(34.2)

The devaluation of sterling over the period significantly improves the returns from European and North American indices in sterling terms (from €1.44 to €1.12, and from $1.63 to $1.45 respectively). It is a sobering fact that the Nikkei Index stands at little more than 20% of the all-time high that it reached nearly 20 years ago in December 1989.

1 There are choices of well-known indices in the UK and the US. In the UK, the FTSE 100 is now the most frequently used index and is little different in capitalisation and performance from the FTSE All Share Index. Other indices vary. The FTSE 250 has performed better with a rise of 59% since May 1997 but its tiny capitalisation of only one-tenth that of the FTSE 100 is not representative. The long-standing FTSE 30 has always included large companies that reflect a cross-section of the UK economy. It has performed much worse with a fall of 49%. In the US, the Dow Jones is still the most publicly quoted index but its performance now diverges significantly from the much more widely based S&P 500. The latter has fallen by 27% since May 1997, whereas the Dow Jones has risen by 13%.

2. TAXATION AND REGULATION

Rising taxation and the imposition of regulations have been persistently negative themes running through the 12 years of Labour Government.

Taxation

Despite the commitment not to increase the standard and higher rates of income tax, the overall burden of personal taxation has persistently risen, primarily due to what have become known as stealth taxes. Although the headline rate of Corporation Tax has been reduced from 33% to 28%, the overall burden of corporate taxation has increased, particularly relative to other economies. It has now reached a level that is prompting companies to seek friendlier tax regimes by moving their corporate headquarters out of the UK.

A common feature of the previous three post-war Labour Governments was that the burden of taxation rose during each of their periods of office. New Labour has followed down the same path, as shown by OECD figures below.

Government expenditure as % of GDP

	1997	2008	Difference	Stock Market return %
Spain	41.6	39.7	(1.9)	128.1
Canada	44.3	39.6	(4.7)	96.9
Germany	48.3	43.4	(4.9)	70.6
Italy	50.2	48.4	(1.8)	50.2
Australia	36.3	33.7	(2.6)	47.9
France	54.1	52.5	(1.6)	47.3
United States	35.4	38.6	3.2	1.0
UK	**40.6**	**45.4**	**4.8**	**(9.3)**
Japan	35.7	36.4	0.7	(34.2)

There is a strong correlation in this table between the direction of government expenditure and stock market performance. The UK combines the worst performance (outside Japan) with the largest increase in government expenditure, closely followed by the US. All other countries have seen cuts in government expenditure *and* growth in their stock markets.

New Labour, despite its claims to economic responsibility, had few scruples about introducing taxation policies that discriminated against profits and dividends. Two such tax measures were introduced immediately upon their election victory. A windfall tax was imposed on the profits of successful privatised utilities amounting to a one-off levy of £5 billion. Far more harmful was the decision to abolish the tax credit of 20% on dividends received by pension funds, announced by Gordon Brown on 2 July 1997. This measure raised £5.4 billion, of which approximately £4 billion related to pension funds. The seriousness of its impact was that it would be a permanent annual loss of revenue that, combined with the loss of compound interest, has so far cost pension funds at the least around £80 billion. This has been a significant factor in the closing to new entrants of the great majority of “defined benefit” pension schemes, where the pension is based on a percentage of final salary. The Institute of Directors recently estimated that only 12% of private sector employees now look forward to a defined benefit pension, in contrast to 90% of public sector workers.

Falling stock markets and the recent collapse of interest rates are causing a pensions crisis for company pension schemes with a recent estimate by the Pensions Protection Fund of an assets shortfall of £228 billion for funds in deficit. Employees dependent on “defined contribution” self-invested schemes are suffering grievously from the falling value of their pensions savings and low annuity rates.

In contrast, in 1997 the combination of public and private sector pensions in Britain was widely believed to be the best in Europe. Over the last 12 years, private sector pensions have been irretrievably damaged and the Government has averted its eyes from the “pensions apartheid” that is creating a serious employment distortion between the wealth-creating private sector and the tax-spending public sector.

Closely linked with the Chancellor's removal of this tax credit was the abolition a few months later in November 1997 of advanced corporation tax, itself the basis of the imputation tax system for corporate profits. The significance of this reform was that it introduced an element of double taxation with corporation tax charged on profits and income tax charged on dividends paid out of taxed earnings. This measure reduced the value of dividends in the hands of shareholders. This was reflected in the overnight reduction of 17% in the dividend yield on the FT-Actuaries All Share Index from around 3.5% to 2.9%.

One example of an instinctive prejudice against ordinary shareholders was the highly favourable capital gains tax concession introduced by Gordon Brown of a special rate of 10% to business and private equity investors. The implication is one of approval of founding shareholders but disapproval of the more passive secondary shareholder, whose capital gains often quickly reached a marginal rate of 40%. The anomalies created by this were removed in the 2008 Budget when Alistair Darling introduced a single capital gains tax rate of 18%.

Gordon Brown has also immeasurably complicated the taxation regime. In 1997, *Tolley's Yellow Tax Handbook* was published in two volumes with 4,998 pages. The 2008 edition is one of the longest in the world, stretching to four volumes with 10,134 pages – now in smaller type size.

Regulation

Britain in the 1990s had become one of the most competitive and most lightly regulated economy in the European Union. This is no longer the case: the burden of regulation on business imposed by the Labour Government since 1997 has now reached £77 billion, according to calculations published by the British Chambers of Commerce in their latest *Burdens Barometer*.

It began with the signing of the Social Chapter immediately on taking power in 1997. John Major had successfully negotiated for Britain an opt-out from the Social Chapter in the Maastricht Treaty, fearing that it would open the doors to waves of directives and regulations, any of which could be voluntarily adopted rather than being imposed upon us.

Compliance with the Social Chapter and other EU directives has proved both costly and distracting. The British Chambers of Commerce estimate that £53 billion, or 69% of the total cost of regulation of £77 billion, has originated from the EU. The largest single item has been the Working Time Directives at a cost of £19 billion. Regulations emanating from the UK are estimated to have cost £24 billion.

More regulation leads inevitably to increasing costs on business. In large and medium-sized companies, this burden has been more easily carried by an expansion of the human resources, finance and administration departments. In smaller companies, the burden is greater because it has to be carried either in the form of extra consultancy costs or by distracting executives from their main business.

The UK's competitive advantage has thus been eroded as the economy is gradually brought into line with the social market model of the major European economies. Ironically, as the earlier table shows, European governments have been reducing their expenditure while the UK has been expanding it. Government expenditure in Germany is now lower than in the UK (as a proportion of GDP).

3. INTERNATIONAL LEAGUE TABLES

Certain international institutions publish annual league tables of the comparative performance of different countries judged by criteria relating to the strength, growth or competitiveness of their economies. These league tables offer an objective snapshot of the state of play of each country and over a period of time show the direction in which any country is heading. The long-term trends make poor reading for the UK since 1997.

1. .The World Economic Forum

The global competitiveness report published by the Geneva-based World Economic Forum is probably the most widely publicised of these league tables. It lists countries in order of their “underlying prospects for growth over the coming five years”. The following table shows the annual ranking of the UK.[2]

1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
4	8	8	12	11	15	11	13	10	9	12

---

2 Note that the WEF has revised its ranking system a number of times. The data here show the original and not the amended ranking.

Economic growth is the favourite indicator for Gordon Brown, but in this survey we are steadily falling behind. In 1998, reflecting encouraging prospects outlined earlier by the OECD, the UK stood in fourth place behind the US, Singapore and Hong Kong. Today we languish in twelfth place, having been overtaken by Switzerland, Germany and the Netherlands from continental Europe; Denmark, Sweden and Finland from Scandinavia; and Japan and Canada.

2. The Institute for Management Development

The Swiss-based Institute for Management Development publishes a world competitiveness scoreboard. As well as background criteria, they also incorporate data about actual performance. The following table shows the ranking of the UK.

1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
9	13	19	15	17	16	19	20	20	20	20	21

3. The Heritage Foundation

The Index of World Economic Freedom is co-published by the US-based Heritage Foundation and *The Wall Street Journal*. It uses different background criteria to assess the economic freedom of structures in place in each country. The following table shows the annual ranking of the UK.

1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
5	5	6	4	7	7	9	9	7	6	7	10	10

There is a consistent pattern in these international surveys. They all show a gradual decline in the competitive position and economic strength of the UK since Labour came into office.

4. THE STEWARDSHIP OF GORDON BROWN

The poor performance of the London stock market under the Labour Government mirrors the record of the three previous Labour Governments. In each case, equities have failed to match inflation, let alone participate in the growth of the economy.

It is possible to look back to the Attlee, Wilson and Wilson/Callaghan administrations and conclude that they were Governments with strong socialist instincts that would have been averse to prospering stock markets. But the Blair Government claimed to have deliberately and persuasively rejected the socialist beliefs of previous Labour governments. This was to be the era of 'New' Labour with no more public ownership, a new financial responsibility and no more 'boom and bust'.

And yet, 12 years later, we have the worst performing stock market of any post-war government, a chronic burden of 'tax and spend' and the biggest 'boom and bust' since the 1930s. This has happened with a Government that came to power with a golden economic inheritance.

Gordon Brown has to take some responsibility for this. As Chancellor, he operated, it would seem, independently from the Prime Minister in assuming sovereignty over the financial decisions of government. One of his particular characteristics has been never to admit to mistakes. This attitude is best typified by his constant refusal to admit that his decision to sell 12.7 million ounces of gold at an average price of $275 between 1999 and 2002 might possibly have been an error of judgement. The price of gold has risen every single year since 2002 and has recently touched $1000 an ounce.

A reading of his 11 Budget speeches and ten Pre-Budget Reports also reveals a boastful Chancellor. He would combine grand principles and fiscal rules with an obsession for detail. His manipulation of statistics to prove or deny any statement or criticism was without parallel. He became a formidable opponent with as clever and as calculating a political mind as any post-war politician. He became the “Iron Chancellor” and was widely described in his party and in other quarters as one of the “great“ post-war Chancellors.

However, examination of those Budget and Pre-Budget speeches shows that his overall management of the economy was badly flawed. He grossly underestimated the strength of the economy in his first term and then lost control of it in his second and third terms with his Old Labour “tax and spend” policies. His annual forecasts of the surpluses or deficits that would follow from his Budgets were repeatedly wrong. The ill-judged and chronic deficits of the last six years have been his responsibility. While he now denies that these deficits, or any other of his policies, might have played any part in the problems of the recession, events show that it is a myth that Gordon Brown was ever a great Chancellor.

The Golden Inheritance

Gordon Brown has always been in denial about the golden inheritance in 1997. Indeed, it can be argued that it was his failure to recognise the strength of the economy that led him down a path of unnecessary fiscal restraint during his first term as Chancellor from 1997 to 2001. But there can be no doubt that the economy was strong in 1997; and in striking contrast to the struggling economies inherited by every other post-war Labour or Conservative Chancellors when power had changed hands between the two parties.

He inherited an economy that had shown steady economic growth during every quarter for five years and that had grown faster than both France and Germany in each of those five years. Unemployment and inflation had both been falling steadily. Moreover, these achievements were internationally recognised. In its 1997 *Annual Report*, the IMF judged the state of the UK economy to be “enviable”. In its *World Economic Report* in December 1996, the OECD stated in glowing terms: “The prospects for achieving sustained output growth and low inflation are the best in 30 years.”

A further endorsement came from Hans-Olaf Henkel, the head of the German equivalent of the CBI: “Britain is now the European country best equipped to face the challenge of global competitiveness.” And in the final Conservative budget on 26 November 1996, the Chancellor, Kenneth Clarke, reported:

> “This Budget will ensure that Government borrowing keeps coming down. I expect the public sector borrowing requirement to be £26.5 billion this year. I expect it to come down to £19 billion next year (1997-98) and to be broadly in balance by 1999–2000.”

The first term (1997-2001)

Shortly before the 1997 General Election, Gordon Brown announced that a Labour Government would stick to existing Conservative spending plans during their first two years in office. This promise he kept.

In his first Budget on 2 July 1997, he announced a deficit reduction programme, seeming to ignore that such a programme was already in place. He decided to tighten fiscal policy by some £5 billion in that current financial year and a further £5 billion in the following year:

> "Borrowing was projected in the previous Budget to be £19.25 billion this year, but it is now set to be £13.25 billion, and borrowing that was projected to be £12.25 billion next year is now set to be £5.5 billion. So our deficit reduction plan ensures that borrowing, which was £22.75 billion last year, is now set to fall to £5.5 billion next year."

He repeated these projections in his Pre-Budget Report on 25 November 1997, but only four months later in his Budget on 17 March 1998 he reported differently:

> "Borrowing – which the previous Government had planned at £19 billion for this year – is now expected to be £5 billion. On the same basis, borrowing is expected to fall to just under £4 billion in 1998-99. By 2000, the Budget is forecast to be in balance."

His November forecast of borrowing of £13.25 billion had in the space of a few months suddenly been reduced to £5 billion, attributed by him to a "substantial fiscal tightening". But this was surely much more to do with the buoyancy of the economy that he had inherited. He continued to underestimate the strength of the economy over each of the next three years, as illustrated by the following table of earlier forecasts and the eventual outcomes.

Public Sector Borrowing Requirements (£ billion)

Financial Year	Forecast 3 years earlier	Forecast 2 years earlier	Forecast 1 year earlier	Actual Outcome
1997-1998			13.3	5.0
1998-1999		5.5	4.0	(2.5)
1999-2000		5.0	3.0	(12.0)*
2000-2001	2.0	3.0	(6.5)*	(16.4)

Note that in addition to the surplus of £16.4 billion in 2000-01, a further sum of £22 billion from the sale of mobile phone licences in 2001 was applied to reduce the national debt.

Estimating the balance between the two large figures of government revenues and expenditure is not easy, particularly two or more years in advance. But the difference in forecasts made in the Budget for the financial year that is about to begin, and its outcome just one year later, should be better judged. Gordon Brown persistently underestimated the outcome in each of these four years to the extent of £8 billion, £6 billion, £15 billion and £10 billion respectively, amounting to some £40 billion in total. The tenor of his speeches was to claim that these were all planned savings to achieve financial stability and they allowed "prudence" to become his watchword.

The simpler explanation is that he failed to see the direction in which the economy was travelling. The export and investment led recovery of 1992-97 was now generating increasing consumer spending. This in turn was leading to far higher VAT revenues for the Government.

The first priority for New Labour was to follow a policy of extreme financial caution. Tony Blair and Gordon Brown were haunted by memories of the records of post-war Labour Governments, all of which had left office discredited with a reputation for financial and economic incompetence. In all three cases, income tax and unemployment ended higher than when they came into office; and all had been plagued with either devaluation or flight to the IMF.

A particular feature of Gordon Brown's Budget speeches during this phase was the relentless repetition of his own virtue. A typical example was the opening sentence of his 2001 Budget:

> "Since we came into government our first duty has been to secure economic stability. In 1997, with inflation rising, a £28 billion deficit and a national debt that had doubled, the British economy was once again at risk of repeating the old all too familiar pattern of inflation followed by recession."

The statement is a misrepresentation of the underlying state of the economy. There was a £28 billion deficit but the stringent spending plans that he adopted from the Conservative Government were already in place to eliminate the deficit. The Retail Prices Index (RPI) was up a modest 2.4% over the year to April 1997. Consumer spending was buoyant because of some £30 billion of windfalls to the public from the demutualization of building societies and life assurance companies, but it only needed a touch on the brake to slow spending down.

“National debt doubling” had been another of his election slogans. It was correct but it had increased from the exceptionally low level of 15% in 1991 to 44% in 1997. This he described as an “unacceptable” level but in fact it was identical to the 44.2% aggregate of the 28 developed economies covered by the OECD.

In the same Budget he displayed his rather arrogant and frequently used presumption to forecast the borrowing requirement for five years ahead:

> “Net borrowing, forecast to be in surplus this financial year at £6.5 billion, now yields a surplus of £16.4 billion. As we invest according to our plans, the projections for future years are a surplus of 6, and deficits of 1, 10, 11 and 12.”

These five-year forecasts became a regular feature of his Budgets. They were offered with great authority but were mostly fanciful extrapolations. In the example above he projected a total borrowing requirement over five years of £28 billion. In the event the actual outcome was £134 billion.

The other regular feature of his Budgets was a reminder of the “boom and bust” recessions under the Conservatives and constant boasting of how he had so securely locked stability into the economy that “boom and bust” was now a thing of the past.

The second and third terms (2001-2009)

After the 2001 election, the tight reins over the expanding economy were let loose. It was a return to traditional “tax and spend”. The prudent Chancellor turned into a profligate. This is the record of his Public Sector Borrowing Requirement (PSBR) forecasts :

Public Sector Borrowing Requirements (£ billion)

Financial Year	Forecast 3 years earlier	Forecast 2 years earlier	Forecast 1 year earlier	Actual Outcome	% of GDP
2001-2002	1.0	(5.0)*	(6.0)*	1.3	
2002-2003	3.0	1.0	11.0	27.0	2.5
2003-2004	10.0	13.0	24.0	35.0	3.4
2004-2005	13.0	23.0	33.0	34.0	3.1
2005-2006	22.0	31.0	32.0	37.0	3.0
2006-2007	27.0	29.0	36.0	36.0	2.7
2007-2008	27.0	30.0	34.0	37.0	2.8
2008-2009	25.0	30.0	43.0	90.0	6.3
2009-2010	28.0	38.0	175.0		
2010-2011	32.0	173.0			
2011-2012	140.0				

The PSBR suddenly jumped from £1.3 billion in 2001-02 to £27 billion the next year. The pattern of the Chancellor's stewardship changed. The ending of the dot.com boom in 2001 and a slowdown in economic growth made his spending surge less affordable. The deficit was to be financed by government borrowing.

For the next four years, his forecasts of deficits at the beginning of each financial year stayed within reasonable bounds, but they were always joined with three, four and five year forecasts purporting to reduce the PSBR. These longer-term forecasts became increasingly out of touch with reality. For example, in April 2002, he forecast aggregate deficits of £37 billion for the three years to 2004-05 and £72 billion for the five years to 2006-07. The outcomes were £96 billion and £169 billion respectively.

This chronic overspending has continued every year since 2003. For the six successive years to 2007-08, the PSBR has averaged around £34 billion within a tight range of £27 to £37 billion. As a percentage of GDP at around 3%, it has reached and remained at levels that would have been unacceptable in the Eurozone. It has formed the worst possible starting point for entering any recession, let alone one of its current severity. These were years of good economic growth that should have been creating government surpluses, just as they did under Nigel Lawson in 1989 and 1990 and for Gordon Brown between 1999 and 2001.

A feature of all Gordon Brown's Budgets is the endless parade of statistics favourable to his cause. His annual assertions of Budget surpluses, borrowing requirements and debt ratios to GDP for the following five years have no credibility.

National debt as a percentage of GDP

In 1997, one of the Labour Party's election slogans had been that "national debt had doubled under John Major." With its clear implication that because it had doubled it was therefore too high, Gordon Brown seized upon this ratio and determined to bring it down.

It is true that the national debt had more than doubled from the extraordinary low levels to which it had been driven down by Nigel Lawson in the late 1980s. But the level he inherited in 1997 compares reasonably with other countries:

National Debt as percentage of GDP (OECD figures)

	1990	1991	1992	1993	1994	1995	1996	1997
UK	14.5	15.2	22.1	31.9	32.5	38.3	40.4	42.6
France								42.3
Germany								33.5
Japan								34.8
United States								49.8
Total OECD								44.2

In his first Budget, Gordon Brown announced that "public debt will be held at a prudent and stable level over the economic cycle". He launched a five-year deficit reduction programme. This was justified on the grounds that debt interest payments were absorbing too large a proportion of government revenues. But he never drew any international comparisons. In fact net debt interest payments were 3.1% of GDP, exactly in line with the OECD average of 28 countries. Despite these comparisons, he simply asserted that he had inherited an "unacceptable" level of debt.

Nevertheless, later he justified his own budget deficits because of our comparatively low level of debt at below 40%. A typical example of the use of selective and remarkably inaccurate forecasting can be found in his 2005 Budget:

> "And while debt is now forecast to rise to nearly 50% in America and France, nearly 60% in Germany and 90% in Japan, in Britain this year debt is forecast to be just 34% of our national income."

According to OECD figures from 2004 to 2007 debt in France fell steadily from 45.3% to 39.2%; in the US, it increased slightly from 43.0% to 44.2%; in Germany it fell from 48.0% to 46.7%; and in Japan it increased from 82.7% to 88.1%.

Gordon Brown made a virtue of low government debt, but excluded from it the financing of government projects by Private Finance Initiatives (PFI). These take capital costs "off-balance sheet" and postpone them to be paid for by future generations. Some estimates suggest that they could add up to 2% to the ratio of government expenditure to GDP. The unfunded liability of the contracted commitment to pay final salary pensions to public sector workers is variously estimated at several hundred billions. If this were to be included in the national debt, the percentage would rise dramatically.

Inflation and interest rates

A typical example of his frequent references to inflation and interest rates can be found in the 2005 Budget:

> "In the 18 years from 1979 to 1997, inflation averaged 6%. In the last eight years inflation has been 2.4% – half as much. In the 18 years from 1979 to 1997 interest rates averaged 10.4%. In the last eight years interest rates have averaged 5.3% – half as much."

These comparisons have been a theme of every Budget. They purport to show that, somehow single-handedly, he has lowered inflation and interest rates to half those under the Conservatives. What he never mentions is the strong following wind that he has enjoyed from a shift across the world to lower rates of inflation over the last decade.

Similar comparisons of halved inflation and halved interest rates can be made for just about every developed economy. For example, based on OECD figures, inflation in the Euro area averaged 5.4% from 1979 to 1997, falling to 1.9% over the last eight years, a rather better outcome than Gordon Brown was claiming at the expense of the Conservative record.

As for interest rates, the UK has not enjoyed particularly low interest rates over the last 12 years. Based on OECD figures over the period of his stewardship, UK interest rates have been an average of 60% higher than in the Euro area and 55% higher than in the US. Compared with long term trends the situation that has developed over the last six months is exceptional.

Balance of Payments and Savings Ratios

Two important features of the economy under Labour have been a deterioration in the current account of the balance of payments from a near balance in 1997 to 3.8% of GDP in 2007; and a collapse in the savings rate from 9.6% of disposable household income in 1997 to a marginally negative percentage in 2008. In both cases the deterioration was gradual.

In his 21 Budget and Pre-Budget Report speeches, supposedly reporting the state of the economy to the nation, Gordon Brown makes no reference to the balance of payments and only one reference to the savings ratio. This was in his 2005 Budget. It is a classic example of the manipulation of statistics:

> "The household savings ratio is now 5.6% – four times that of the U.S.A. and Canada."

The savings ratio has hardly ever increased under New Labour. But it so happened that in 2005 the ratio jumped rather sharply from 3.7% in 2004. Worth a mention this one time, but the comparison with the US and Canada was ludicrously selective. He chose not to mention that the double figure percentages in France, Germany, Italy and Spain were almost twice as high as in the UK.

5. LABOUR AND THE STOCK MARKET : WHERE ARE WE NOW?

Rarely has hubris turned with such speed into nemesis as in the endlessly repeated refrain from Gordon Brown of “no more boom and bust”. He used it to the very end in his final Budget on 21 March 2007 – “we will not return to the old boom and bust” – just six months before the first run on a bank in living memory. He now seeks to escape from this boastful promise on two grounds. The first is that the recession is “global” and the second is that the credit crunch causing the recession “started in the United States”.

His first argument, that this recession is global and that it is different from the Conservative recessions of the 1980s and 1990s, does not stand up to analysis. The 1980-82 recession was widely international with OECD figures for the economies of all developed countries showing a low point of a fall in aggregate real GDP of 0.1% in 1982, highlighted by a fall of 2.1% in the US. The 1991-93 recession shows GDP growth for all developed countries falling to 1.1%, 1.9% and 1.2% in those three years, with an actual decline in the European Union of 0.5% in 1993.

His second argument, that the credit crunch began in the US, is self-serving. In the UK, the credit crunch began in September 2007 with the collapse of Northern Rock whose notorious 125% mortgages had nothing to do with the US but everything to do with a failure of regulation and failure of leadership of the economy.

Undoubtedly this recession is worse than the previous two and its global reach is wider, but its consequences are all the greater and more damaging for Britain because of the policies pursued by Gordon Brown during his flawed stewardship of the economy. In particular, the most serious aspects have been failing to regulate the banks and allowing huge mountains of debt to accumulate.

When Gordon Brown in 1997 handed over responsibility to the Bank of England for setting interest rates through a Monetary Policy Committee, he at the same time took away from the Bank of England their responsibility for the regulation of banks. He said in his statement to Parliament on 20 May 1997:

> "There is a strong case for bringing the regulation of banking, securities and insurance together under one roof."

In reply, the Shadow Chancellor, Kenneth Clarke observed that

> "The regulation of all financial services and of banking has hitherto been done by separate people with separate skills. The Chancellor now proposes that they should be brought together in a way that is still to be defined in a massive piece of legislation".

This was a perceptive comment. Those separate niche skills were dissipated in the Financial Services Authority (FSA) that was created to regulate and supervise all banks and providers of financial services. It would work with the Bank of England and the Treasury to form a tripartite authority, in itself a prescription for confusion and inaction and much weaker than the specific responsibility previously held by the Bank of England.

The FSA has grown into an expensive bureaucracy of some 3,000 employees costing £350 million a year. It is seemingly more interested in ticking boxes to show that institutions were correctly following procedures and due process rather than in exercising judgement about the validity and risks of the business models emerging in the City. Lord Turner, the new chairman of the FSA, referred to this when giving evidence recently to the Treasury Select Committee on 26 February. He observed that the FSA staff did not believe it was part of their role to challenge the business models of the banks and that political thinking supported "light touch" regulation.

For the supervision of banks, the box-ticking FSA was not a proper replacement for the role of the Bank of England. It used to be said that all that was needed to curb bad financial practices was for the Governor of the Bank of England to demand information and "to raise his eyebrows" in quiet conversation with the chairman of an offending bank or institution. This informal system without rules might or might not have worked to restrain the reckless borrowing and lending practices that have brought down so many of the banks. But clearly its replacement, the FSA, did not. The FSA was a creation of Gordon Brown. It failed.

A reading of Gordon Brown's Budget speeches suggests that his highest priorities were stability and economic growth. He certainly extended the 20 successive quarters of positive economic growth that he inherited in 1997 to an all-time record of 63 quarters in early 2008. However, in effect he bought the growth by a “tax and spend” policy of borrowing £34 billion a year for six years, by condoning record levels of personal debt and bank lending and by encouraging immigration.

In so doing he has not created a financial structure that “places us in a better shape to face recession” as he has so often claimed. Rather, he has recklessly left the country with levels of personal, banking and government debt that will take a decade or more to unwind. The savings ratio fell to zero and record balance of payments deficits were financed by the sale of corporate assets to foreign owners. Alarmingly, sterling has been sharply devalued by around 25% with a speed and extent reminiscent of the behaviour of sterling leading up to the IMF crisis in 1976. Over the last six years Gordon Brown has justified government borrowing on the grounds that our national debt has been a lower percentage of GDP than in comparable economies. Living off chronic levels of borrowing is the reverse of living off capital. Both become difficult habits to break and usually end in tears.

Far from stability it is irresponsibility that will be his epitaph. During his reign as Chancellor and Prime Minister personal debt as a percentage of GDP in Britain has risen to over 100% to be the highest in the world. He has judged rising house prices to be affordable because mortgage rates are lower, but as that bubble bursts millions are exposed to negative equity. Rising house prices were used as a source of capital to finance consumer spending through millions of second and third mortgages. Bank lending with its exposure to toxic and other debt as a percentage of GDP is amongst the highest of countries of comparable size. Gordon Brown presided over these personal and banking debts and enjoyed the revenues that flowed from them into the Exchequer.

Not only did he enjoy the revenues, but also he recklessly over-spent. The situation was well described by Andrew Gowers, former editor of *The Financial Times*, on Channel 4 News on 12 February 2009:

> "The whole system was geared to breakneck growth fuelled by easy money and debt and that applied to the boards and management of banks, it applied to ordinary citizens and it certainly applied to politicians. New Labour's reign coincided with the most extraordinary growth in the City and New Labour did many things that facilitated the activities of financial firms whether it be private equity, hedge funds or the investment banks. New Labour was enjoying the fruits of that, New Labour is now reaping the whirlwind."

Annual borrowing deficits of £34 billion have been running for six years. Yet Gordon Brown remains in denial that this is not the best preparation for the onset of recession. And yet he blames others for doing exactly what he did himself. In an article on future regulation in *The Sunday Telegraph* on 15 March 2009, he wrote:

> "We will need to do more to make sure banks put aside more capital during the good times so that they are better insulated from downturns."

The recession has prompted massive spending on a financial stimulus and the rescue of the banking system. In recent evidence to a Treasury Select Committee, the Governor of the Bank of England, Mervyn King stated that "we entered this crisis with levels of public borrowing which were too high". The result as the Chancellor, Alistair Darling, forecast in his Pre-Budget Report in November 2008, is that the PSBR will rise to 8% in 2009-10, before gradually being brought back into line in 2015-16. However, this assessment of the prospects for the economy has, as widely expected, proved to be grossly optimistic.

Recovering from that position will be made more difficult because it is the financial sector that has been the engine of growth in the economy accounting for 8% of GDP and at least 15% of corporation tax and income tax. It has now witnessed a collapse of corporate profits and personal incomes. The promised imposition of tighter regulation and a much reduced level of activity will make it unlikely that revenues from the financial sector will return to their previous levels for many years. The judgement of the rest of the world about our prospects of recovery has been stark. Sterling has lost 27% of its value on a trade-weighted basis since the collapse of Northern Rock and as the Prime Minister himself once said, "a weak currency is a sign of a weak economy"

Several years ago, the prudent Chancellor turned into a profligate. Since then the ship of state has been sailing towards the iceberg to the refrains of "no more boom and bust". Now it has hit the iceberg and government borrowing is rising to an alarming level of 12.4% of GDP.

The valuation of shares has fallen dramatically since 1997 when the FTSE 100 stood on a price/earnings ratio of 16. Today this ratio has fallen to 7, with investors fearful of heavily falling profits. But it is still above the average ratio of only 4 reached in the worst of the 1972-74 recession. Dividends are now being widely cut and the dividend index on the FTSE 100 has fallen by 15% since mid-2008.

The Government has built a mountain of debt. It sits alongside bank debts of frightening amounts and a personal debt mountain built on a boom in house prices. All will have to come down to earth and for this to happen the economy faces a long haul of higher taxation and tightly constrained government spending that could last for a decade or more. Against this background the future for the economy and the stock market remains bleak.

An iconic figure from the eighteenth century was the landscape gardener, “Capability” Brown, so named because he viewed the scene before him and pronounced it to be capable of his time and attention. Viewing the scene in recent years has been “Calamity” Brown, feasting on the boom and oblivious to the bust.

APPENDIX

THE PERFORMANCE OF THE UK STOCK MARKET

Three indices have been used to measure the movement in share prices – the Financial Times 30 Index (FT30) up to 1964; the Financial Times All-Share Index (ASI) to 1997; and the FTSE 100 Index to 2009. The Retail Price Index has been used to measure inflation up to 1997 and the Consumer Price Index (CPI) to 2009.

Dates	Index	Change (%)	Inflation (%)	Real Return (%)
1. Labour				
25 July 1945	118.4			
25 October 1951	138.3	16.8	26.3	– 7.5
15 October 1964	106.85			
18 June 1970	120.63	12.9	29.7	– 13.0
28 February 1974	149.27			
3 May 1979	280.28	87.8	112.3	– 11.5
1 May 1997	4445.0			
22 April 2009	4,030.7	– 9.3	23.0	– 26.3
2. Conservative				
25 October 1951	138.3			
15 October 1964	364.9	163.8	50.9	74.8
18 June 1970	120.6			
28 February 1974	149.3	23.7	39.4	– 11.3
3 May 1979	280.3			
1 May 1997	2,138.9	663.1	186.1	166.7

THE CENTRE FOR POLICY STUDIES

The Centre for Policy Studies stands for freedom. We trust people to make decisions about their lives. We believe this not just because freedom breeds prosperity, but because it is right. People should free to live as they choose, to spend their money as they wish. The State should be their servant, not their master.

We know where we stand: the State should do less, and do it better. Our nation's history tells us that the bigger the State, the less freedom and prosperity we enjoy. A smaller state is a freer, richer, more fulfilled Britain.

For that to be our future, much must change.

- The State should spend less, so that taxes and borrowing can be cut.
- The State should do less, and give private enterprise the opportunity to deliver services to the public.
- The State should recognise the importance of families, as they are the best welfare system ever known.
- The State should intrude less, and respect people's privacy more.

BECOME AN ASSOCIATE OF THE CENTRE FOR POLICY STUDIES

Through our Associate Membership scheme, the Centre for Policy Studies welcomes all those who support our ideals and who wish to be actively involved in the battle of ideas.

Associate Membership is available for £100 a year (or £90 a year if paid by bankers' order). Becoming an Associate will entitle you to:

- all CPS publications produced in a 12-month period
- invitations to lectures and conferences
- advance notice by e-mail of our publications, briefing papers and invitations to special events

For more details, please write or telephone to:

The Secretary
Centre for Policy Studies
57 Tufton Street, London SW1P 3QL
Tel: 020 7222 4488
Fax: 020 7222 4388
e-mail: mail@cps.org.uk
Website: www.cps.org.uk

Centre for Policy Studies

RECENT PUBLICATIONS

What killed Capitalism? The crisis: what caused it and how to respond by Andrew Lilico

“a powerfully argued paper” – Bill Jamieson, *The Scotsman*

Step off the Gas: Why over-dependence on gas is bad for the UK by Tony Lodge

“Dire consequences of relying on imported gas” – headline in *The Sunday Times*

Save 100,000 homes from repossession by Natalie Elphicke

“Repossession plans not enough” – BBC *Online*

Ticking the right boxes: why multiple tests are a better and cheaper alternative to SATs by Tom Burkard

“The report comes amid continuing controversy about the role of national curriculum tests” – *The Times*

The 2009 Lexicon: a guide to contemporary Newspeak

“The much-praised 2009 Lexicon from the Centre for Policy Studies contains some hitherto-overlooked gems of interest to business readers” – *The Mail on Sunday*

Freedom for Public Services by William Mason & Jonathan McMahon

“Labour handed £15 billion job cut plan” – *News of the World*

The Price of Irresponsibility by Brooks Newmark MP

“The Great Debt Lie” – headline in *The Daily Mail*

Centre for Policy Studies

From Boom to Bust: a plain guide to the causes and implications of the banking crisis by Howard Flight

"Every Cabinet member, indeed every MP and PPC should memorise and then understand Howard Flight's Pointmaker" – *Conservativehome.com*

The New Good Council Guide by Stephen Greenhalgh

"I have seen the Conservative future and it works" – op-ed headline in *The Sunday Telegraph*

Enemy of the People by Maurice Saatchi

"THE best indictment of the Labour years" – ConservativeHome.com

In Bad Faith by Cristina Odone

"Faith schools betrayed by Labour" – *Evening Standard*

Inside Out: how to keep drugs out of prison by Huseyin Djemil

"a devastating new report" – *The Observer*

Big, not Better: evidence from 20 countries that slim government works better by Keith Marsden

"An excellent report and I absolutely loved reading it" –Art Laffer

Why do we feel so broke? by Charlie Elphicke

"…electoral dynamite" – Iain Martin, *The Daily Telegraph*

Who do they think we are? by Jill Kirby

"A feisty pamphlet" – John Lloyd, *The Financial Times*

The London stock market has always performed poorly under Labour Governments, But its performance under this Labour Government has been worse than ever before, falling by 26% in real terms since 1 May 1997. This is (barring Japan) the worst performance of any of the world's major stock markets over the period.

John Littlewood shows how, in 1997, Gordon Brown benefited from a golden inheritance. But in 2007, he passed on a poisoned chalice.

For his Government's policies have created unsustainable government deficits, undermined UK competitiveness, allowed asset bubbles to develop and permitted irresponsible risk-taking by banks to go unchecked.

The prospects for the economy, and the stock market, are bleak.

Price £10.00

Centre for Policy Studies