Gordon Brown and British Competitiveness

A statistical analysis

KEITH MARSDEN

CENTRE FOR POLICY STUDIES
2003

THE AUTHOR

KEITH MARSDEN is an economics consultant to several UN agencies. He was previously an operations adviser at the World Bank, a senior economist in the International Labour Office, and an economist in British industry. He has undertaken studies and advisory missions in over 60 countries, and has written numerous articles on economic policy for *The International Labour Review*, *Finance and Development*, *The European Journal, Aspenia, l'agefi, The Guardian, The New York Times,* and *The Wall Street Journal*. Recent publications include *Miracle or Mirage?: Britain's economy seen from abroad* (Centre for Policy Studies, 1997), *Is Tax Competition Harmful?* (European Policy Forum, 1998), *Handicap, not Trump Card* (CPS, 1999), *The Five Per Cent Solution* (CPS, 2000), *Towards a Treaty of Commerce* (CPS, 2000), and *Miracle or Mirage: New Labour's Economic Record in Perspective* (CPS, 2001). He was educated at Quarry Bank High School, Liverpool, Lancaster Royal Grammar School and Cambridge University. He is married to a French citizen from the Béarn.

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 No. 1 903219 58 2

57 Tufton Street, London SW1P 3QL

Printed by The Chameleon Press, 5 – 25 Burr Road, London SW18

CONTENTS

SUMMARY

- This paper presents a statistical analysis of Gordon Brown's record as Chancellor of the Exchequer. It compares the original promises, pledges, aims, and statements he has made since 1997 with the impact of his policies since then.
- The analysis is based on data published by the OECD, IMF, World Bank, World Trade Organisation, Eurostat and the Office for National Statistics.

Economic Growth (Chapter 2)

- The 1997 New Labour manifesto stated that "an explicit objective of a Labour Government will be to raise the trend rate of growth".
- The trend rate of growth has fallen. In the first five calendar years of New Labour, real GDP grew by an average of 2.4% p.a., compared to 3.2% p.a. over the last five years of the Conservative Government.
- Gordon Brown has blamed the slowdown in the UK on "the global downturn". This is misleading. The growth in world GDP has fallen only marginally (from an average of 3.6% p.a. in 1993-97 to 3.3% p.a. in 1998-20002).
- If the UK had kept pace with the average world growth rate, national income per household would be £1,900 higher per year.

Monetary Stability (Chapter 3)

- In the 1997 Budget Report, Gordon Brown promised that he would "create economic stability based on low inflation".
- Inflation has declined slightly in Britain, as in the rest of the world. Consumer price inflation has fallen from an average of 2.8% over the period 1993-95 to an average of 2.2% from 1998-2002.

- The overall fall in UK inflation masks an important disparity in the economy: while prices in much of the private sector have fallen dramatically since 1995, average prices of government services such as health and education have risen by 31%.
- Deflation is now a real threat for the UK economy.

Taxation (Chapter 4)

- In his 1997 Budget Report, Gordon Brown stated that one of his aims was "keeping the overall burden of taxation as low as possible".
- The burden of taxes has risen from an average of 34.9% under the Conservatives to 37.3% under the Labour Government. Taxes are now £100 billion a year higher than they were under the Conservatives, equivalent to £4,000 per household per year.

Savings (Chapter 5)

- Gordon Brown stated in his 1997 Budget Report that he wanted to "promote savings to underpin long-term investment", and to "encourage individuals to secure their own financial welfare for the future".
- Household savings have fallen from an average of 9.7% of available household resources in 1993-97 to just 5.1% in 2002. Compared to a positive financial balance from 1993-97 averaging £24.5 billion a year (or over £1,000 per household per year), households now have a negative average balance under the Labour Government.
- Companies have also increased their indebtedness. In 1995, UK companies had a positive financial balance equal to 1.0% of GDP. By 2001, this had fallen to –2.4% of GDP.

Investment (Chapter 6)

- Gordon Brown stated that the "key to future economic success is investment" in his 1997 Budget Report.
- Real fixed investment in Britain grew at an average annual rate of 2.3% (in constant prices) over the period 1998-2002 compared to 4.0% from 1993-97. Total business investment has fallen from 12.5% of GDP in 1998 to just 10.0% in 2002.

SUMMARY

Training (Chapter 7)

- Gordon Brown promised in his 1997 Budget Report that "the Government is committed to promoting investment in training".

- Government spending on labour market training amounted to 0.16% of GDP in 2000 in the UK, down from 0.22% in 1996. This is less than half the amount spent in France and Germany.

Employment (Chapter 8)

- Labour's 1997 Manifesto promised: "we will get the unemployed from welfare to work".

- The proportion of the working age population in work has remained almost static since 1990 at around 71%, suggesting that there are limits to the effectiveness of Government welfare-to-work programmes.

- While the overall employment ratio has been static, the number of government employees has grown by 300,000 between June 2000 and March 2003 (up by 4.4%), while the number of people employed in manufacturing has fallen by 465,000 (down by 11.1%).

Productivity (Chapter 9)

- In the 1999 Budget Report, Gordon Brown stated that "raising productivity is the key to high rates of growth in people's incomes."

- Between 1993 and 1997, UK productivity growth averaged 2.4%. Between 1998 and 2002, this fell to 1.4%.

R&D (Chapter 10)

- The 1997 Budget Report said that: "the Government recognises the key contribution that investment in innovation and technology can make to growth and competitiveness."

- UK expenditure on R&D has fallen from 2.2% of Gross National Income in 1995 to 1.8% in 2000. The UK's R&D spending ratio is substantially below that of major competitors such as the US (2.5%), Japan (2.8%), Germany (2.5%) and France (2.2).

Regulation (Chapter 11)

- The 1997 Labour Manifesto had promised: "we will cut unnecessary red tape".

- The regulatory Impact Assessments – produced by government departments – show that the impact on business of the costs of regulations introduced between May 1997 and May 2002 is £15 billion.

Entrepreneurship (Chapter 12)

- In the 1997 Budget Report, Gordon Brown said he would "encourage entrepreneurial, outward-looking and internationally competitive businesses."
- The number of new businesses being set up is in decline. By mid 2002, England and Wales had 2.67 million businesses, the lowest stock since the first quarter of 1998.

International Trade (Chapter 13)

- The 1997 Labour Manifesto pledged to "promote dynamic and competitive business and industry at home and abroad".
- Britain's share of world exports of goods and services dropped to 5.0% in 2000 from 5.4% in 1997. Between 1993-97, real growth of Britain's exports grew at an average rate of 7.8%. This fell to an average of 4.1% between 1998 and 2002.
- The latest trade data suggest that Britain's competitiveness is in sharp decline. The value of exports of goods (excluding oil) fell by 2% in 2002, and by 6.2% in the three months to May 2003 over the same period last year. In the three months ending in May 2003, exports of goods to the EU shrank by 14.9% in volume from March-May 2002. Britain's world-wide exports of finished manufactures dropped by a huge 12.3%. While Britain still enjoyed a positive global trade balance in services, exports of services fell by 2.9% in the latest three months (March-May 2003) compared with the previous three months, and its trading surplus narrowed. Overall, a positive balance for goods and services of £186 million in 1997 has now become a deficit of £22.5 billion in 2001.

CHAPTER 1

INTRODUCTION

GORDON BROWN presented his first Budget Report (Red Book)[1] to Parliament in July 1997. It began with a damning critique of Britain's past economic performance:

> Britain is a nation full of talent and potential. But too often in the past that potential has been squandered, with repeated cycles of boom and bust. Inadequate investment in education and training, and in the application of new technologies, has left Britain trailing the best of the world… British people have had too few opportunities to find jobs, start new businesses or become self-employed. The British industrial base is too narrow.

All that would change. Higher investment would play a key role, the Chancellor promised:

> Unless Britain can improve its investment record relative to other countries, it will be unable to compete effectively with them in the modern world and improve its relative prosperity.

His 1997 Budget therefore laid out a set of strategic objectives, and specified the policy instruments that would be applied to enhance Britain's competitiveness and raise its rate of economic growth. Six subsequent Budgets have reiterated the same goals and policies, with remarkably little variation in approach from year to year. Yet, surprisingly, the Red Books have not charted the progress achieved or evaluated the effectiveness of the policies applied.

---

1 *Equipping Britain For Our Long-Term Future*, HM Treasury, July 1997.

GORDON BROWN AND BRITISH COMPETITIVENESS

After nearly six years in office, an evaluation of Gordon Brown's economic leadership and management skills is overdue. In particular, this pamphlet analyses the following issues:

- Has Gordon Brown achieved his main strategic goals?
- How has the British economy fared in comparison to our main trading partners?
- Has the British economy fared better under Gordon Brown than it did under his predecessors?

To answer these questions, data published by independent organisations such as OECD, IMF, World Bank, WTO, Eurostat, and Britain's Office for National Statistics (ONS) will be compared with statements made by Gordon Brown in his budget speeches and the promises made in New Labour's 1997 election Manifesto.

CHAPTER 2

ECONOMIC GROWTH

Goals

New Labour's 1997 election Manifesto stated without equivocation:

> An explicit objective of a Labour Government will be to raise the trend rate of growth by strengthening our wealth-creating base.

This goal was re-emphasised in Gordon Brown's first Budget Report. His declared aim was to "improve the underlying rate of growth". He complained that "the British industrial base is too narrow". The British economy would be improved by "creating economic stability", and enabling "the British economy and the British people adapt continuously to change". "A successful strategy requires solid foundations", the Chancellor argued. "Too often in the past, the British economy has been subject to excessive swings in economic performance, so-called boom and bust. For over a decade no other major country in the European Union has suffered such large fluctuations in output" as the UK, the 1997 Budget claimed. By implication, Gordon Brown set out to eliminate boom and bust. Indeed, this oft-repeated phrase has become his signature tune.

"Improving the underlying rate of growth?"

Chart 1 shows that Britain's economic growth has slowed significantly since 1997. Real GDP rose at an average rate of 2.4% over the first five calendar years of New Labour Government, compared with 3.2% over the last five years of the Conservatives.[2] From 1993 to 1997, Britain had easily outpaced its main

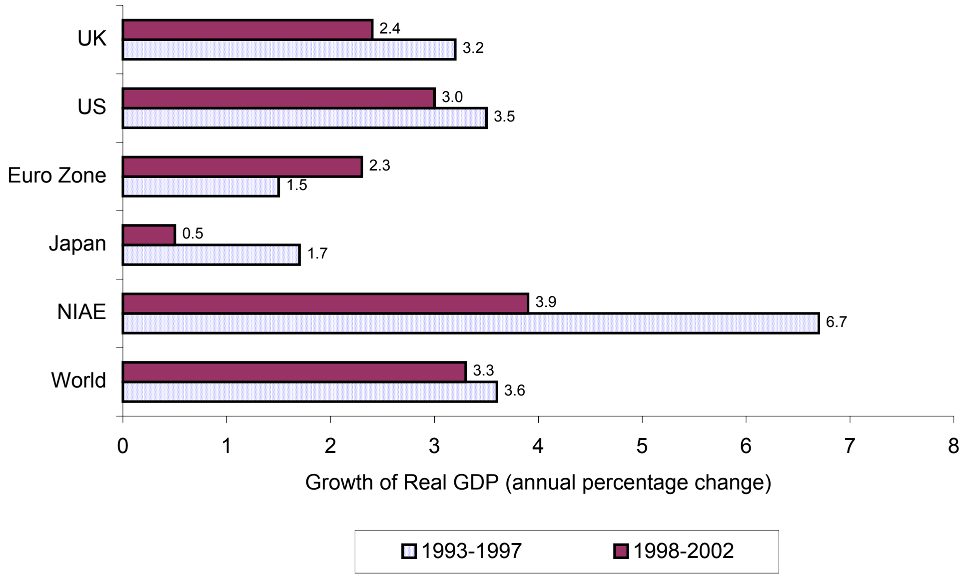
[2] 1998 is the appropriate starting point for an evaluation of Gordon Brown's record for several reasons. There are inevitable time-lags between New Labour assuming office (in May 1997), its announcement of new policies, their actual implementation, and their impact on the economy. Similarly, 1997 is taken as the final year of Kenneth Clarke's Chancellorship because the economic indicators for that calendar year mostly reflect the results of past Conservative policies.

European and Japanese rivals, growing more than twice as fast as the Euro zone as a whole, and lagged only slightly behind the world's GDP growth rate of 3.6%.

Britain's weaker subsequent performance cannot be attributed wholly to Labour's policies. It also reflects a slightly less buoyant global economic environment. World output rose at an average rate of 3.3% from 1998-2002. And the growth of the previously high-flying Newly Industrialised Asian Economies (NIAEs)[3] slowed dramatically to an average rate of 3.9%, from 6.7% over the 1993-97 period. US growth has also dropped significantly since 1997, averaging 2.9% compared with 3.5% over the previous five years.

Chart 1

The slow-down in Britain's economic growth



Source: IMF, *World Economic Outlook*, April 2003, Statistical Appendix Tables 1 and 2.

Britain has enjoyed many five-year periods of recession-free expansion since 1945. But the last five years has been the most sluggish of them all. Slow growth has a cost. If Britain had just kept pace with the world's GDP growth rate since 1997, national income per household would now be nearly £1,900 higher. And the medium–term prospects are not bright. The ONS reports that GDP rose by just 0.1% in the first quarter of 2003, barely keeping pace with population growth.

---

3 Hong Kong, Korea, Singapore and Taiwan (Taipei).

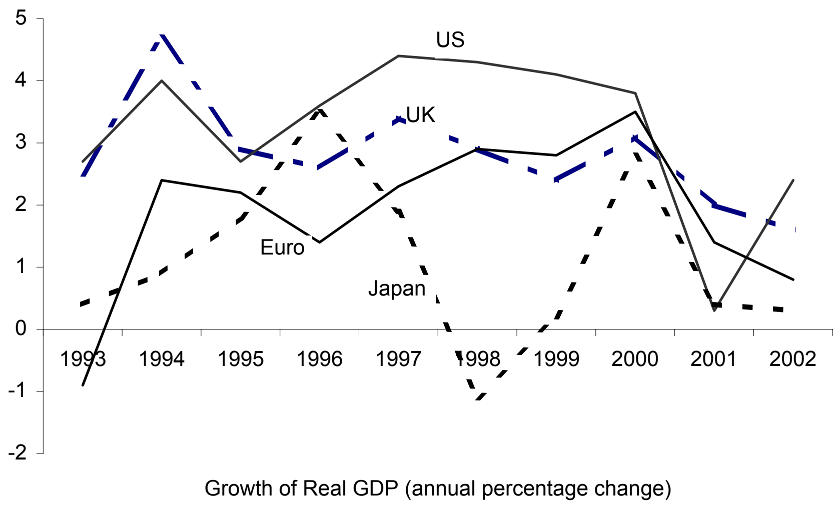
ECONOMIC GROWTH

"Stable economic growth"?

Chart 2 shows that stable economic growth cannot be achieved by waving a magic wand. British growth rates have varied substantially over the last five years, from a high of 3.1% to a low of 1.6%. And other countries have experienced considerable volatility. The Euro zone was in recession in 1993. Japan suffered a severe downturn in 1998, and very sluggish growth in three of the last five years. US GDP was virtually stagnant in 2001, after climbing at an average annual rate above 4% from 1998-2000. Output in the NIAEs soared by 8.0% in 1999, after contracting by 2.4% the previous year. This evidence emphatically rejects Gordon Brown's claim (repeatedly reiterated) that "boom and bust" was a purely Conservative phenomenon that could be cured by "prudent" domestic policies. The trade cycle has not been eliminated, nationally or globally. And no country is immune from external shocks.

Chart 2

No end to "boom and bust"



Source: IMF, *World Economic Outlook*, April 2003, Statistical Appendix Tables 1 and 2.

Faced with the possibility of a return to Labour "bust", Gordon Brown tried to claim – incorrectly – that the British economy was outperforming the rest of the world. He told the House of Commons on 18 November 2002:

> In a global down turn deeper and more serious than that of the early 1990s, Britain is doing better than the rest of the world, whereas in the early 1990s, faced with a lesser contraction in global growth and output, Britain did far worse.[4]

---

[4] Reported in *The Times*, 22 November, 2002.

Data published by the IMF, OECD, and ONS show these claims to be false. Output has not contracted globally in recent years, nor has Britain done better than the rest of the world. For example, the IMF has reported the following growth rates in GDP:

Table 1

Britain is not doing better than the rest of the world

Real Growth in GDP
(in percentages)

	2001	**2002**	**2003***
UK	2.0	1.6	2.2
World	2.3	3.0	3.2

*IMF projection
Source: *IMF World Economic Outlook*, April 2003, Statistical Appendix Table 1.

In contrast, the world experienced a more severe, and longer sustained, economic slowdown during the early 1990s than it has in the early 2000s. According to the IMF, world real GDP expanded at an average rate of 3.3% from 2000-2002, compared with 2.2% from 1991-93. Moreover, Britain suffered a double whammy (external shocks) in the early 1990s. In 1991, seven of its main (OECD) markets, including the US, were in recession (defined as a drop in GDP), and three countries experienced a more severe contraction than Britain's (–1.4%). Then in 1993 its largest combined market (members of the current Euro zone) shrank. Euroland's total real domestic demand fell by 2.1%. Italy's collapsed by 5.1%, Spain's by 3.3% and France's by 1.7%. Yet Britain's GDP rose by 2.7% in 1993, and its total exports of goods and services went up by 4.4% that year.[5] This robust performance in a sluggish world economy is a tribute to the resilience and competitiveness of the British economy under the Tories, and rejects Gordon Brown's slur that Britain "did far worse" than the rest of the world during the early 1990s.[6]

Many countries have achieved higher growth rates than Britain over the last two years. By focusing his comparison on Euro-zone countries, where progress has been retarded by high taxes and inflexible labour and product markets, the Chancellor has diverted attention away from the more dynamic, newly industrialising economies. Only five of the top 20 economies in the world are in the EU.[7] China, the second biggest economy, expanded at a 7.8%

---

5 OECD, *Economic Outlook,* June 2002, Statistical Annex, Tables 1, 8 and 9.

6 Of course, Britain's exports were boosted by the depreciation of the pound following its exit from the Exchange Rate Mechanism in September 1992, while exports have been hampered by overvaluation of the pound in recent years.

7 Measured by their Gross National Income in purchasing power parity dollars.

average rate from 2000-2002, and the IMF forecasts it will attain 7.5% growth this year. India, the fourth largest economy, has maintained a 5.3% average rate over the last four years, and is forecast to do nearly as well (5.1%) in 2003. In fact, Britain's growth has lagged well behind most members of the premier league under New Labour. As shown in Table 2, it was ranked only 12th in the average annual growth rate from 1998-2002. Britain can ill afford to ignore countries outside the EU or the G7 group. Newly emerging economies offer large markets as well as strong competition.

Table 2

Britain's low growth rate in the World Premier Economic League Table

Country	**Gross national income ($ppp billions) 2001**	**Size rank 2001**	**Real GDP (average annual % growth rate) 1998-2002**	**Growth rank 1998-02**
US	9,781	1	3.0	9
China	5,027	2	7.6	1
Japan	3,246	3	0.5	18
India	2,913	4	5.4	2
Germany	2,078	5	1.5	16
UK	**1,431**	**6**	**2.4**	**12**
France	1,425	7	2.8	10
Italy	1,422	8	1.8	14
Brazil	1,219	9	1.6	15
Russia	995	10	3.8	=5
Canada	825	11	3.8	=5
Mexico	820	12	3.2	8
Korea	713	13	4.5	=3
Indonesia	591	14	-0.1	19
Australia	478	15	3.8	=5
S Africa	472	16	1.9	13
Netherlands	439	17	2.6	11
Argentina	412	18	-3.2	20
Turkey	386	19	1.0	17
Iran	383	20	4.5	=3
World	**45,183**		**3.3**	

Sources: World Bank, *World Development Indicators,* 2003, Table 1.1; and IMF, *World Economic Outlook,* April 2002, Statistical Appendix Tables 1, 2, 5, 6 and 7.

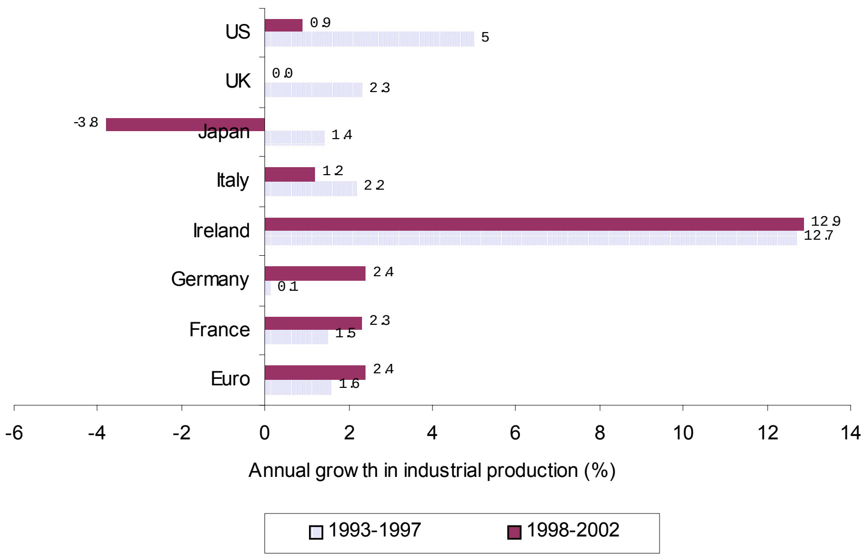
Because this measure takes price differences into account, it is a more meaningful indicator of relative economic size and capacity than one based on current exchange rates.

"The British industrial base is too narrow"

Britain's industrial base has not broadened since 1997. According to the European statistical agency Eurostat, output from the whole of Britain's industrial sector (mining, manufacturing and utilities) shrank by 3.7% over the last two years, and is now no higher than in 1997. Yet it had expanded at an average annual rate of 2.3% under Kenneth Clarke's term as Chancellor (see Chart 3). Britain has lost ground to its industrial competitors in Europe since Labour took over. Industrial output in the Euro zone increased by 2.4% annually from 1998-2002, and Ireland's exploded by a massive 12.9% annually. In contrast, Japanese industry is in a sorry state, experiencing a contraction of nearly 20% over the last two years. US industry has also suffered a serious recession over the same period, after enjoying buoyant expansion of nearly 5% annually over the previous eight years.

Chart 3

No expansion in Britain's industrial base under New Labour…

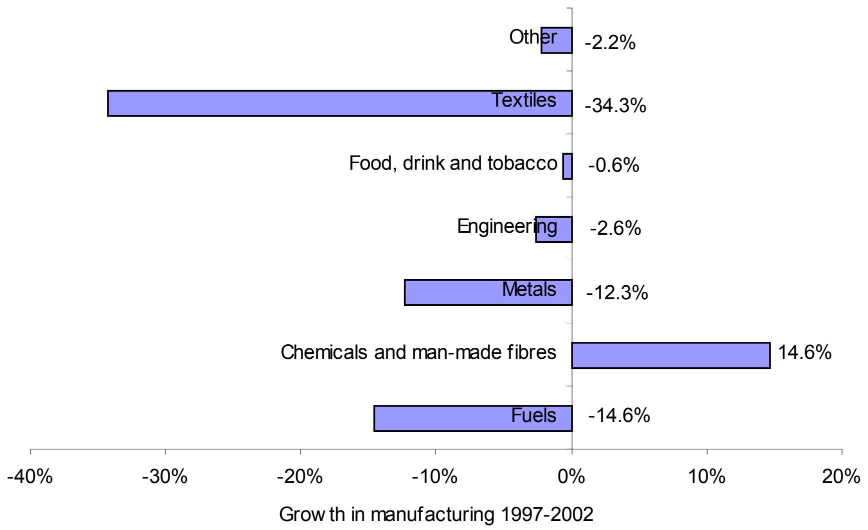


Source: Eurostat, *EC Economic Data Pocket Book*, No. 9, 2002, Table 4.

Britain's manufacturing base is narrowing. Output of textiles has fallen by over a third since Gordon Brown took office, output of fuel by 15%, and output of metals by 12% (see Chart 4). The engineering and allied industries have been on a real roller-coaster. Their turnover rocketed by some 14% from 1997 to 2000, but then plunged by over 14% over the last two years.

Chart 4

…and a contraction in Britain's manufacturing base



Source: ONS, *Index of Production*, 9 May 2003.

"Creating economic stability?"

The evidence shows that Gordon Brown's much vaunted economic stability might be called a statistical accident, or even a mirage. Boom and bust have not been conquered. Rapid expansion in some sectors has been offset by slumps or stagnation in others. The performance of different sectors of the economy has varied greatly in Britain. For example:[8]

- agriculture, forestry and fishing have been depressed, with output falling by 11% between 1999 and 2002;
- mining production has fallen by 8% since 1999;
- manufacturing is in the doldrums, falling by 3% since 1997;
- growth in the service industries was at first spectacular but has slowed since 2000;
- output of post and communication services soared by 85% from 1997 to 2001, but growth then slackened to just 2.8% in 2002;
- wholesale and retail trade has enjoyed strong growth, but at a slower pace since Labour took office, falling from an average annual rate of 4.8% from 1993-97 to just 3.6% from 1998-2002.

This wide variation in performance cannot accurately be described as stability.

---

8 Following data are from ONS, *The Blue Book*, 2002, Table 2.4 and ONS, *Quarterly national accounts*, 4th quarter 2002, 27 March 2003, Tables B1 and B2.

CHAPTER 3

MONETARY STABILITY

Goals

"We will provide stable economic growth with low inflation." This was one of the ten "five-year contracts with the people" pledged by New Labour in its 1997 Manifesto. Similar language was used in the 1997 Budget Report. It set out the Government's intentions to:

> …create economic stability based on low inflation and low government borrowing… Without stability, and the confidence of future stability, businesses and individuals cannot plan effectively for the long term.

Has Britain experienced lower inflation than other countries?

Inflation has declined in Britain. But this is a global phenomenon. The IMF reports that consumer prices rose in the EU at a ten-year average rate of 4.3% from 1985-94. It estimates the rate will drop to 2.2% from 1995-2004. In Britain the projected drop is from 4.8% to 2.5% over these two decades (see Table 3). There has been little change in consumer price inflation over the first five years of Labour Government compared with the last five of the Conservatives (averaging 2.2% and 2.8% respectively).

However, low inflation does not necessarily boost economic growth. Nor do high price increases create an insurmountable barrier to sustained expansion. The GDP deflator measures the average annual rate of price change in the economy as a whole. During the 1985-1994 period, the newly industrialised Asian economies combined an average GDP deflator rate of 5.6% with a GDP growth rate of 7.8%. Over the last decade they reduced their GDP deflator rate by three quarters to 1.2%, but their average output growth rate also fell – to 4.7% during the decade and 3.9% over the last five years.

Japan's experience is more ominous. The IMF expects its GDP deflator will fall to an average of just 1.0% over the 1995-2004 period. The curb on inflation was poorly rewarded. Japan's GDP growth rate averaged just 0.5% over the last five years.

Table 3

Britain's inflation in line with the rest of the world

	GDP Deflators (10 year averages, annual % change)		Consumer Prices (10 year averages, annual % change)	
	1985-94	**1995-2004**	**1985-1994**	**1995-2004**
UK	5.0	2.7	4.8	2.5
US	3.0	1.8	3.6	2.4
Canada	3.0	1.7	3.5	2.0
Germany	2.9	1.0	2.4	1.5
France	3.2	1.3	3.1	1.6
Italy	6.4	2.9	6.4	2.8
Japan	1.4	-1.0	1.6	-0.2
EU	4.6	2.1	4.3	2.1
NIAE	5.6	1.2	4.8	2.4

Source: IMF, *World Economic Outlook,* April 2003, Statistical Appendix Table 9.

Is UK inflation too low for comfort?

The IMF has recently warned that deflation could become a global problem. Demand side shocks – such as the bursting of an asset price bubble – are generally accompanied by a slowdown, or a decline, in economic activity. Deflation is seldom benign, particularly if wages are rigid: sectors not experiencing productivity improvements, with rigid wages and falling prices, are likely to face higher real labour costs and a loss of competitiveness. Regardless of the source of the shock, deflation, especially when unanticipated, leads to a redistribution of income from debtors to creditors – that is, from groups with a high propensity to spend to those with a low propensity, depressing demand. Moreover, given the zero-interest rate floor, the effectiveness of monetary policy is curtailed and can cause severe disruption to financial institutions.

The biggest concern is that a temporary period of declining prices could develop into a more sustained and self-reinforcing deflationary spiral, as expectations of falling prices become entrenched, consumption and investment are postponed, and risk-appetite drops off. So far, sustained deflation has been experienced only in Japan. However, given that the Consumer Price Index is subject to an upward bias of between 0.5% and 1% (by ignoring substitution possibilities and new or improved products), measured inflation of 1% or less may in practice be close to price stability, or even deflation. If so, mild deflation may already be affecting a substantially higher proportion of industrial economies.

Looking ahead, a number of factors could exacerbate deflationary pressures. The pace of global recovery is likely to remain sluggish, reflecting geopolitical concerns as well as the continued effects of share price declines.

The latter, particularly through their impact on corporate balance sheets and financial institutions, may restrain activity more than currently anticipated. House prices, which have increased substantially in many countries, thus helping to mitigate effects of equity price declines on consumption, could experience a correction, exacerbating the weakness in household demand. There has also been a notable decline in private sector credit in many countries, reflecting subdued demand but also in several cases banking sector difficulties.

Deflation in the private sector, high inflation in the public sector

In short, the fact that Britain's inflation rates have been brought down to the lowest levels for decades may not be the resounding success Gordon Brown claims. Britain too faces a deflation risk. Producer's output prices are stagnant. The index (1995=100) stood at 103.4 in the fourth quarter of 2002, and has increased by less than 1% in total over the last five years (see Table 4). Significant falls have occurred over the last year in the prices of petroleum products, electrical and optical goods, and textiles and clothing. British export prices have dropped more than 5% since 1995. Prices of exports to Europe are down by 11% since 1995. Producers' input prices for raw materials and energy in 2002 were 17% below the 1995 level.

In contrast, average prices (costs) of public sector consumption – that is, of government services including health and education – have risen six times as fast as the prices of all forms of consumer expenditure since 1999. Public sector inflation is the inevitable result of a sudden acceleration in government expenditure. Total current spending by the central government rose by 14% from fiscal year 2000/01 to 2002/03. Excluding social benefits and interest payments, current spending on government services rose by a massive 19.6% over the last two years, resulting in an overall deficit on the Government's current account of nearly £12 billion.[9] As supplies of skilled health personnel and teachers are inelastic in the short term, public sector labour costs are likely to jump further, thus limiting the real benefits that consumers of public services will receive from their higher tax bills.

9 See ONS, *Public Sector Finances,* 19 June 2003, Tables PSF 1 and PSF 3.

Table 4

31% inflation in the public sector since 1995, deflation in producer prices

	UK Price Indices (1995=100)								
	1995	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2002†**
GDP at market prices	100	103.3	106.2	109.4	112.1	114.6	117.2	121.0	122.3
Consumers' expenditure	100	103.1	105.5	108.3	110.1	110.8	111.9	112.8	113.1
Public sector consumption	100	102.9	104.5	106.8	111.5	116.6	122.5	128.8	131.2
Fixed investment	100	102.3	102.1	101.7	102.9	104.6	107.1	110.7	111.8
Exports	100	101.3	97.1	93.1	91.4	93.0	93.1	94.2	94.8
Imports	100	100.1	93.0	87.2	85.0	85.6	85.5	83.6	82.8
Producer input prices	100	95.8	89.7	85.9	83.1	85.8	86.1	83.3	82.9
Producer output prices	100	101.9	102.1	102.0	101.6	102.4	102.6	103.0	103.4
Retail prices	100	102.4	105.6	109.3	111.0	114.2	116.3	118.4	119.5

*excluding food, drink, tobacco and petroleum
† fourth quarter
Source: *National Institute Economic Review (NIER)*, April 2003, Statistical Appendix, Table 6.

Can "businesses plan effectively for the long term"?

Large disparities in inflation rates between the public and private sectors are certainly not the "economic stability" Gordon Brown has been seeking since 1997. Moreover, it is difficult for enterprises to plan for, or even consider, further investment if they fear that the market prices for their goods and services may fall while their labour costs continue to rise. The average compensation of employees has increased by 4.9% annually since Gordon Brown has been Chancellor, up from a 3.7% annual rise over the previous five years. Britain's labour costs have outstripped those of its main rivals, particularly Germany and Japan, putting producers at a competitive disadvantage (see Chart 5).

Wide divergences in the movement of asset prices are also not conducive to stability. By the fourth quarter of 2002, house prices were 94% higher than in 1997, and continue to rise rapidly, whereas equity prices were then 37% below the average in 2000.[10]

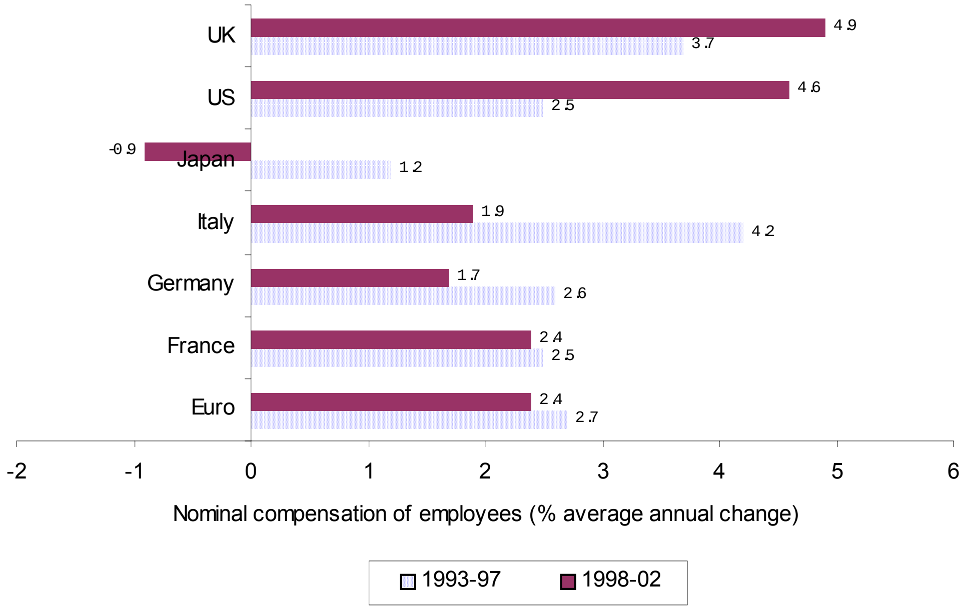
Deflation is particularly damaging when an economy is awash with debt. Private sector debt is now much higher than when deflation was last experienced in the 1930s. Falling prices not only increase the real burden of debt, they also make it impossible for a central bank to deliver negative real interest rates as a monetary stimulus, because nominal rates cannot go below zero. If deflation causes real debts to swell, debtors may have to cut spending and sell assets to meet their payments. This can unleash a vicious spiral of falling incomes, asset prices and rising real debt.

---

10 *NIER,* No. 182, October 2002, and *NIER,* No. 184, April 2003, Table 10.

Chart 5

High wage inflation in the UK under New Labour…



Source: Eurostat, *EC Economic Data Pocket Book*, 2002, Table 14.

CHAPTER 4

TAXATION

Goals

New Labour's 1997 Manifesto clearly set out to dispel Labour's image as a "tax and spend" party:

> Save to invest is our approach, not tax and spend… New Labour is not about high taxes on ordinary families… Our long-term objective is a lower starting rate of income tax. This goal will benefit the many, not the few… New Labour will establish a new trust on tax with the British people. The promises we make we will keep.

These promises were echoed in the 1997 Budget Report. Gordon Brown's aims included:

i. "Keeping the overall burden of tax as low as possible";
ii. "Improve the climate for business investment by cutting corporation tax rates and removing a bias in the tax system which distorts the financing of investment";
iii. "Develop a tax system which is fair and seen to be fair".

Results

The tax burden jumped sharply in 1998, to 37.0% of GDP from 35.6% in 1997, and has inched up further since 1999. Over the five years of Gordon Brown's fiscal administration, the tax burden will average 37.3%, 2.4 percentage points more than during the last five years of the Conservatives. British businesses and citizens paid out over £100 billion more in taxes in 2001 than they did in 1996 (see Table 5 and Chart 6).

Table 5

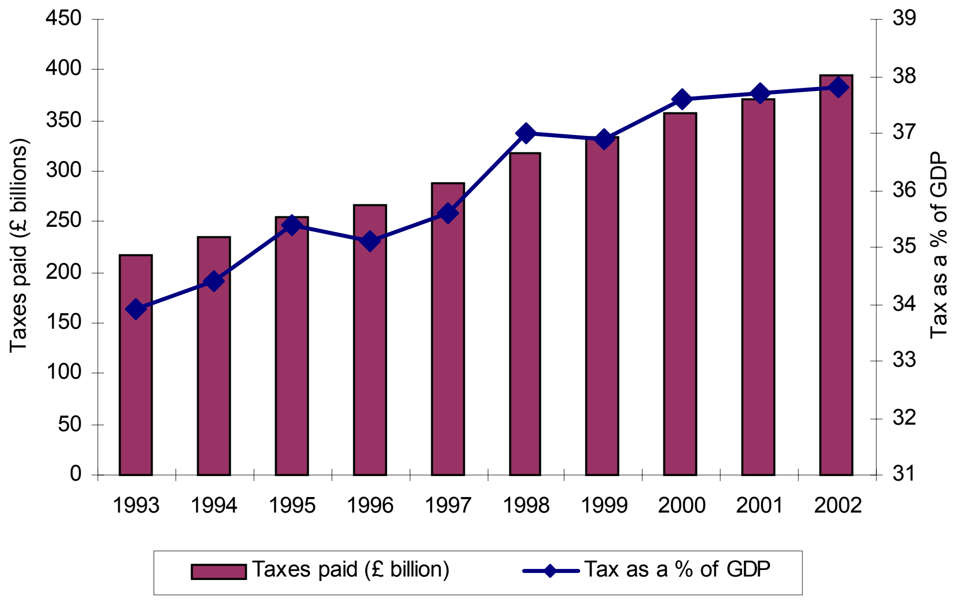
£100 billion more tax under New Labour…

	Average 1993-97	Average 1998-02
Taxes paid (£ billion)	252.5	354.8
Tax as a % of GDP	34.9	37.3

Notes: taxes are gross taxes and compulsory social contributions paid by UK residents to general government and the European Union. Data for 2002 are estimates.
Sources: ONS, *Blue Book,* 2002, Table 11.1, and *UK output, income and expenditure*, 23 May 2003 Table C1; and HM Treasury, *Budget Red Book,* 2003, Table C8.

Chart 6

and an increasing tax burden under New Labour



Sources: as above.

Britain's tax burden tops those of some of its G7 competitors, including the US, Japan, Canada and Germany. And these figures understate the government's total take because they exclude non-tax revenue such as fees and royalties. Other OECD data show that total government receipts climbed to 39.3% of GDP in Britain in 2001, a full three percentage points above the 1996 level.

Britain's tax burden is also much higher than that imposed by rapidly industrialising countries like Korea and Mexico (see Table 6). Among non-OECD counties now competing in the world's premier economic league ,central government tax to GDP ratios are generally far lower – 6.8% in China, 10.0% in India, 13.2% in Indonesia and 22.5% in Russia, for example.

Gordon Brown's fiscal appetite is fast converging towards those of the "big" governments on the Continent. The average revenue/GDP ratio for the Euro zone dropped to 43.5% in 2001 from 44.7% in 1996. The US ratio was 30.9% in 2001, slightly up from 30.2% in 1996.

Table 6

UK taxes converging with Euroland's, diverging from growth economies

	Total Tax Revenue as a % of GDP						
	1975	**1985**	**1990**	**1995**	**1999**	**2000**	**2001***
Mexico	n.a	17.0	17.3	16.6	17.3	18.5	18.3
Korea	15.3	16.9	19.1	20.5	23.6	26.1	27.5
Spain	18.8	27.8	33.2	32.8	35.0	35.2	35.2
Japan	21.2	27.2	30.1	27.7	26.1	27.1	n.a
Italy	26.1	34.4	38.9	41.2	43.3	42.0	41.8
United States	26.9	26.1	26.7	27.6	28.9	29.6	n.a
Canada	31.9	32.6	35.9	35.6	35.9	35.8	35.2
Germany	35.3	37.2	35.7	38.2	37.8	37.9	36.4
France	35.9	43.8	43.0	44.0	45.7	45.3	45.4
United Kingdom	35.3	37.7	36.8	34.8	36.4	37.4	37.4
EU 15	33.2	38.8	39.5	40.0	41.5	41.6	n.a

* Provisional data
Source: *OECD Revenue Statistics,* 1965-2001, Table A.

Taxes on income and profits went up to 14.9% of GDP in 2001, after having been reduced by the Tories to 12.7% in 1995. Gordon Brown took £12.9 billion more directly out of the pockets of businesses, workers, and savers in 2001 than he would have done if the 1995 ratio had been maintained (this sum does not include the increase in VAT and excise duties on products and fuel, stamp duties on property, etc). Britain has one of the highest burdens of direct taxes on income and profits among OECD countries, although below the US level (see Table 7).

Table 7

One of the highest direct tax burdens under New Labour

	Taxes on Income and Profits as a % of GDP				
	1990	**1995**	**1999**	**2000**	**2001**
Mexico	4.7	4.1	5.0	5.0	5.3
Korea	6.2	6.5	5.8	5.0	5.3
France	7.4	7.1	11.0	11.3	11.6
Spain	10.2	9.6	9.8	9.8	10.0
Germany	11.6	11.6	11.3	11.4	10.0
US	12.1	12.6	14.2	15.1	n.a.
Switzerland	12.5	12.2	12.5	13.8	12.8
Netherlands	13.8	11.1	10.5	10.4	10.7
UK	14.1	12.7	14.1	14.6	14.9

Source: *OECD Revenue Statistics,* 1965-2001, Table B.

"Improving the climate for business investment"?

Another way of measuring the burden of the tax and benefit system on British companies is to relate their total outlays to gross value added (GVA). GVA is the value of the gross output of producers of goods and services less the value of intermediate inputs (raw materials, power etc.) consumed in production, before taking account of the consumption of fixed capital in the production process. Companies use their GVA resources to pay wages and salaries to their employees and to make employers' contributions on behalf of their employees, both in the form of compulsory national insurance taxes to the government and payments to insurance companies and pension funds for private (voluntary) social security schemes.

Employers also often make contributions to private medical schemes, and pay for sickness and maternity leave, and severance allowances. GVA resources must also be drawn upon to pay interest to lenders, dividends to shareholders, insurance premiums, and taxes on production, imports and profits. Whatever is left over is available for new capital investment. It is clear that the higher the percentage of GVA that has to be devoted to taxes, social contributions, and social benefits, the greater the squeeze on investment funds. ONS national accounts data reproduced in Table 8 reveal that these charges have taken up a growing slice of total UK company resources, rising to 31.7% of GVA in 2000 from 25.5% in 1993.

Table 8

More tax, less funds to invest under New Labour

	UK Company Tax and Benefit Payments £ billions								
	1993	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**
1. Gross value added (GVA)	**415**	**451**	**475**	**508**	**541**	**578**	**601**	**638**	**n.a**
2. Wages and salaries	230	244	258	272	294	318	334	354	n.a
3. Fixed capital consumption	61	61	62	63	64	65	66	70	n.a
Taxes									
4. Employers' soc. contributions	43	45	48	54	57	63	72	81	n.a
5. Imputed social contributions	3	3	4	4	4	4	4	5	5
6. Production taxes	13	13	13	14	15	15	16	17	n.a
7. Taxes on company income	13	16	21	24	32	33	34	35	36
8. Social benefits paid by companies	33	36	39	44	49	54	59	64	65
4-8 All taxes, social contributions and benefit payments	**106**	**113**	**124**	**139**	**157**	**170**	**185**	**202**	**n.a**
4-8 Total taxes as a % of GVA	**25.5**	**25.1**	**26.1**	**27.4**	**28.9**	**29.3**	**30.8**	**31.7**	**n.a**

Source: ONS, *Blue Book,* 2002, Tables 3.1.2, 3.1.4, 4.1.2 and 4.1.4.

Higher taxes and social costs have also made it more difficult for employers to maintain company pension schemes, particularly those based on final salaries. A National Audit Office report published on 5 November 2002 highlights the growing trend for employers to shy away from pension commitments. It reports that more than one in five employers have scrapped their pension schemes since 1998. The latest estimates released by Morgan Stanley indicate that the FTSE 100 companies face a combined pensions deficit of £65 billion, calculated on the basis of the FRS 17 accounting standard. However, a new method of analysing the health of company pension schemes developed by the Institute of Actuaries, that looks at whether a company's assets are enough to buy all of its retired workers, current staff and deferred fund members an annuity, show deficits that are 10 to 20% higher.[11]

Corporate income tax payments soared by 76% from 1995 to 2001. But this was not because of a jump in profitability. On the contrary, the average gross rate of return of all private non-financial corporations fell to 11.5% in 2001 from 12.2% in 1997. Manufacturing firms were particularly badly hit. Their average net rate of return tumbled to 3.6% in 2001, from 11.9% in 1997 (see Table 9). The main cause of the rise in tax receipts was a sharp increase in effective corporate tax rates.

Table 9

Falling company profitability under New Labour

	Profitability of UK Private Non-Financial Companies (PNFCs)	
	Manufacturing PNFCs Net rate of return (%)	**Services PNFCs Net rate of return (%)**
1994	8.7	13.3
1995	10.0	13.2
1996	11.1	13.7
1997	11.9	14.7
1998	10.5	16.2
1999	9.3	15.6
2000	8.6	14.0
2001	3.6	12.9
2002 qtr 1	4.6	13.6
2002 qtr 2	4.0	13.4

Source: ONS, *Profitability of UK Companies,* 3 October 2002, Tables 2, 6 and 7.

"Develop a tax system which is fair and seen to be fair"?

Gordon Brown claims to have delivered on his promise to "develop a tax system which is fair and seen to be fair". The middle classes may beg to differ. Table 10 shows how the broad middle classes, defined as the top 60%

---

[11] See report in *The Times*, 10 June 2003.

of households ranked by their disposable incomes, paid an average of £14,260 per household in taxes that could be allocated to households in 2001-02, but received just £6,312 in benefits (in cash and kind).[12] These figures translate into 83.2% of total taxes paid by households, and only 44.9% of the benefits that could be readily attributed to households.[13]

Most better-off families are willing to contribute generously to the costs of ensuring that the poor gain access to basic public services, such as health, education and subsidised housing. But would they be so tolerant of misuses of the system if they were aware of the extent of the biases in tax burdens and benefit distribution? In particular, the concentration of housing benefits on social sector tenants at the bottom end of the income distribution may be questioned, especially when young first-time buyers with medium-incomes face rapidly rising costs for private housing.

Table 10

Middle classes pay 83% of all tax, and receive 43% of all benefits

Distribution of Taxes and Benefits by Household Income Group, 2001-02

	Quintile groups of all households					
	Bottom	**2nd**	**3rd**	**4th**	**5th**	**Average**
TAXES						
Direct taxes and NIC	£1,040	£1,980	£4,220	£7,300	£15,270	£5,960
Indirect taxes	£2,710	£2,920	£4,150	£5,220	£6,630	£4,330
Total taxes	**£3,750**	**£4,900**	**£8,370**	**£12,520**	**£21,900**	**£10,290**
% of total	**7.3**	**9.5**	**16.3**	**24.3**	**42.6**	**100.0**
BENEFITS						
Cash benefits	£5,530	£5,650	£3,950	£2,230	£1,150	£3,700
Benefits in kind:						
Health*	£2,738	£3,209	£2,473	£1,884	£1,501	£2,355
Education*	£1,934	£1,702	£1,573	£1,444	£1,109	£1,547
Housing*	£1,083	£1,083	£722	£516	£180	£722
Other	£132	£84	£62	£64	£77	£84
Total benefits in kind	£5,907	£6,078	£4,830	£3,908	£2,867	£4,708
Total benefits	**£11,437**	**£11,728**	**£8,780**	**£6,138**	**£4,017**	**£8,408**
% of total	**27.2%**	**27.9%**	**20.9%**	**14.6%**	**9.4%**	**100.0%**

Note: * estimates adjusted to reflect actual usage based on large-scale household surveys. Adjustment ratios have been taken from Tom Sefton, *Recent Changes in the Distribution of the Social Wage*, CASE paper 62, November 2002, Table 5.
Source: ONS, *Economic Trends,* May 2003.

---

12 Representing 69.4% of General Government Expenditure. Corporation taxes are excluded from the analysis.

13 Expenditure on defence and public order is not covered because there is no clear conceptual basis for allocation to particular households. Personal social services are also omitted for lack of data.

TAXATION

CHAPTER 5

SAVINGS

Goals: Labour's 1997 Manifesto proclaimed that:

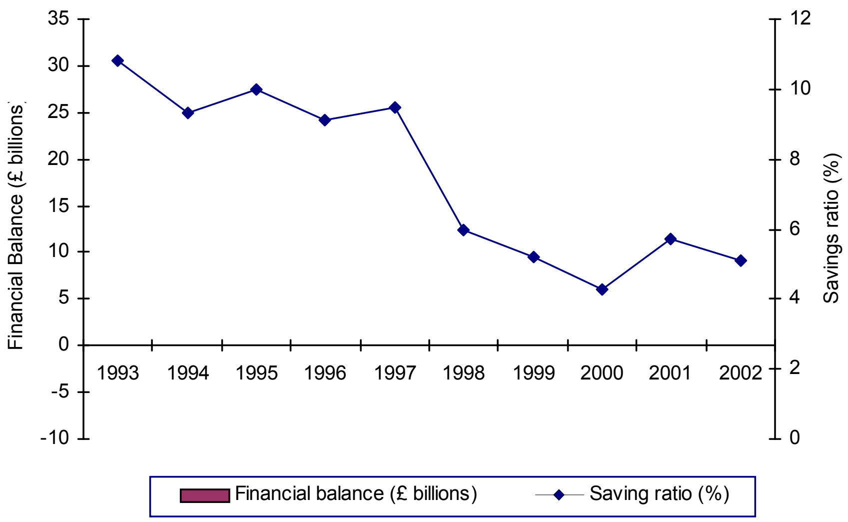
> We will review the corporate and capital gains tax regimes to see how the tax systems can promote long-term investment.

And the 1997 Budget underlined Gordon Brown's determination to "promote savings to underpin long-term investment", and "to encourage individuals to secure their own financial welfare for the future".

Results: The household saving ratio has shrunk to a mere 5.1% of available household resources in 2002, compared with an average of 9.7% in the 1993-97 period. Compared to positive financial balances from 1993-97, averaging £24.5 billion, households went into the red in 1999, 2000 and 2002, and had a negative average balance from 1998-2002 (see Chart 7).

Chart 7

Lower household savings under New Labour…



Notes: Household savings as a percentage of total available households' resources. Savings ratio defined as gross saving less investment and capital transfers.
Source: ONS, *Blue Book,* 2002, Tables 6.1.6 and 6.1.7; and *NIER*, No. 184, April 2003, Appendix Table 8.

Companies have also become more heavily indebted. The financial records for UK companies in aggregate show an accelerating shift from a positive balance equal to 1.0% of GDP in 1995 to a negative balance amounting to 2.4% of GDP in 2001. Net debt (gearing), expressed as a proportion of the market value of private non-financial companies, rose to 32.9% in 2002 from 19.4% in 1997 (see Table 11).

Table 11

...and higher company indebtedness under New Labour...

Company Financial Balances and Gearing

	1995	1996	1997	1998	1999	2000	2001	2002
£ billion	7.1	4.9	-6.5	-9.1	-25.9	-25.4	-23.4	8.8
% GDP	1.0	0.6	-0.8	-1.1	-2.9	-2.7	-2.4	0.8
Gearing	21.1	20.4	19.4	18.7	20.5	21.8	27.5	32.9

Notes: Financial balance defined as gross disposable income less investment and capital transfers. Gearing defined as net debt as a proportion of the market value of private non-financial companies.
Source: *NIER,* No. 181 July 2002 and No. 184, April 2003 Table 7.

Declining profitability has forced companies to borrow more to finance their investment and current operations. ONS national accounts data reveal a dramatic shift as companies moved from being substantial net lenders on both the capital and financial accounts in the 1993-1995 period, to becoming massive net borrowers from 1999 onwards (see Table 12).

Table 12

...and more company borrowing under New Labour...

Net Lending (+)/Borrowing (-) by UK Companies (£ millions)

	1993	1994	1995	1996	1997	1998	1999	2000	2001
Non-financial companies									
Capital account	4,099	12,942	4,276	6,957	-2,192	-3,921	-13,361	-3,986	-10,919
Financial account	5,782	11,139	477	642	-2,350	-9,388	-17,873	-9,688	-11,064
Financial companies									
Capital account	4,202	4,473	2,814	-2,086	-4,298	-5,231	-11,917	-21,421	-23,269
Financial account	10,094	9,420	5,563	-1,545	-4,972	5,290	-8,354	-21,656	-24,835

Source: ONS, *National Accounts Blue Book,* 2002, Tables 3.1.8 and 4.1.8.

As a result, the net worth of non-financial companies turned from being strongly positive in 1993-94 to steeply negative in 1998-2000. A progressive deterioration in the net worth of financial companies also occurred. Some recovery was apparent in both classifications in 2001 however (see Table 13).

SAVINGS

Table 13

…and lower company net worth under New Labour

	Net Worth of UK Companies (in £ billion)								
	1993	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**
Non-financial companies	168	223	90	65	-77	-195	-507	-297	42
Financial companies	-7	-2	-49	-74	-254	-270	-289	-345	-254

Source: ONS, *Blue Book,* 2002, Tables 3.1.9 and 4.1.9.

For the UK economy as a whole, gross national savings averaged just 16.5% of GDP from 1998-2000, compared with an average of 28.1% in Japan, 21.9% in the Euro zone and 18.0% in the US (see Table 14).

Table 14

…and lower gross national savings under New Labour

	Gross National Savings (annual average as a % of nominal GDP)		
	1980-89	**1990-97**	**1998-2000**
UK	17.5	15.5	16.5
US	17.5	16.1	18.0
Japan	32.0	31.7	28.1
Euro zone	21.9	21.6	21.9

Source: OECD, *Historical Statistics,* 2001, Table 6.16.

UK net national savings, after allowing for the consumption of fixed capital, were a miserly 3.4 % of GDP in 2001. This was dwarfed by the net savings ratios in China (30.9%) and Korea (16.9%). Ireland (15.1%) easily topped the EU rankings. The average in the Euro zone was more than double that of Britain (see Table 15).

Table 15

…and miserly net national savings under New Labour

	Gross national savings (% of GNI)		Consumption of fixed capital (% of GNI)		Net national savings (% of GNI)	
	2001	**1997**	**2001**	**1997**	**2001**	**1997**
China	40.1	42.7	9.2	6.2	30.9	36.5
Korea	28.8	34.2	11.9	10.0	16.9	24.3
Ireland	27.4	33.1	12.3	9.2	15.1	23.9
Japan	27.1	30.5	15.9	15.8	11.2	14.6
Canada	23.2	21.5	13.0	12.5	10.2	9.0
Euro zone	21.4	22.1	13.8	12.5	7.6	9.5
France	21.3	19.7	12.6	12.9	8.7	6.8
Germany	20.6	22.4	14.9	13.2	5.7	9.2
US	18.0	16.0	11.9	10.7	6.1	5.3
UK	14.9	15.1	11.5	10.4	3.4	4.8

Sources: World Bank, *World Development Indicators,* 1999 and 2003, Table 3.15.

CHAPTER 6

INVESTMENT

Goals

Investment was identified as key to success in the 1997 Budget Report:

> The key to future economic success is investment – in infrastructure, in technology and in people... This past poor economic performance is a reflection of inadequate levels of investment... The Government wants to increase the quantity of long-term investment in the British economy [by] ensuring a stable economic environment... Unless Britain can improve its investment record relative to other countries, it will be unable to compete effectively with them in the modern world and improve its relative prosperity... The Government is determined to tackle the obstacles holding back long-term investment and competitiveness. Its approach will not be to pick winners, but rather to work with business to create a supportive and flexible environment in which more business can rise to match the best.

These words also echo promises made in Labour's 1997 Manifesto: "We will nurture investment in industry, skills, infrastructure and new technologies".

Results

The ratio of gross fixed capital formation to GDP in current prices jumped to 17.6% in 1998, after averaging 16.2% over the previous five years. But it has dropped every year since, reaching just 15.8% in 2002. (see Table 16). The growth of investment has also slowed. The IMF says that real fixed investment in Britain expanded at an average annual rate of 2.3% in constant prices over the period 1998-2002. But this was largely due to an investment boom in 1998. Over the next four years, investment growth slowed sharply, and actually fell by 4.5% in 2002, giving an average rate for Gordon Brown's period at the helm of just 2.3%. These figures compare with an average rate of expansion of 4.0% during the last five years the Conservatives (see Table 16).

Table 16

Falling fixed national investment under New Labour

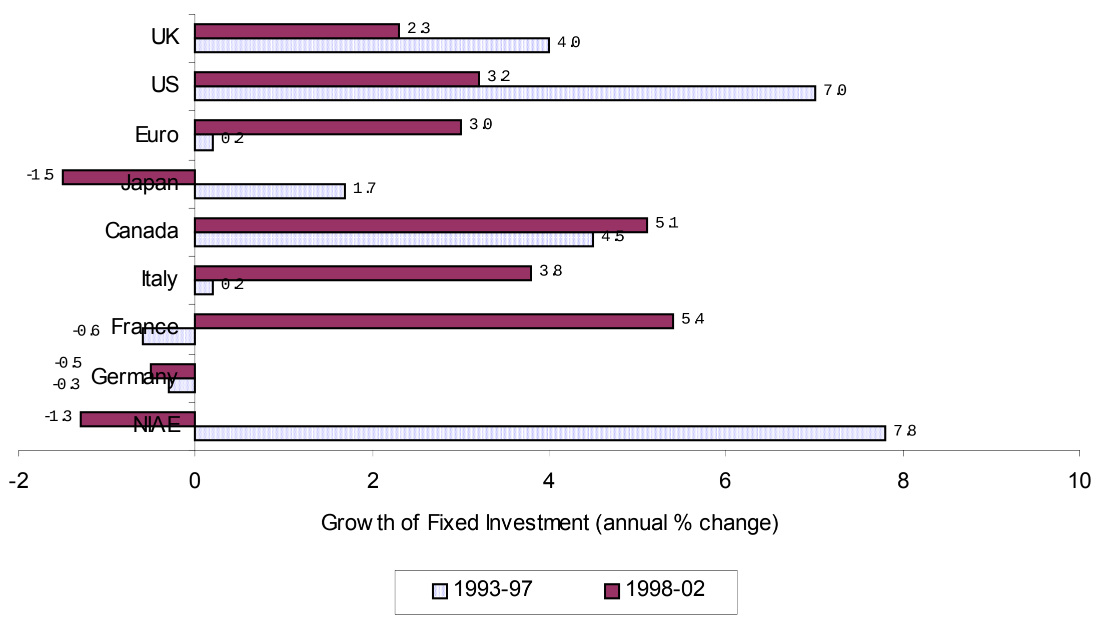
	Gross Fixed Capital Formation (£ billion)	GDP at market prices (£ billion)	GFCF/GDP (%)
1993	101.0	642.3	15.7
1994	108.3	681.3	15.9
1995	117.4	719.2	16.3
1996	125.8	762.2	16.5
1997	134.2	811.1	16.5
Average 93-97	**117.3**	**723.2**	**16.2**
1998	150.8	859.4	17.6
1999	153.5	902.5	17.0
2000	158.9	950.4	16.7
2001	164.3	993.1	16.5
2002	164.5	1,043.3	15.8
Average 98-02	**158.4**	**949.7**	**16.7**

Sources: ONS, *Blue Book,* 2002 Table C1; and *UK output, income and expenditure*, 23 May 2003, Table CI.

The investment record of some of Britain's main competitors has also deteriorated in recent years. Gross fixed capital formation has declined in Germany, Japan and the NIAE group over the last five years overall. But France, the US, Canada, Italy and the EU as a whole have easily topped Britain's investment performance since 1997 (Chart 8).

Chart 8

Britain's faltering investment under New Labour



Source: IMF, *World Economic Outlook,* April 2003, Statistical Appendix Table 3.

Britain's business investment has also fallen well short of expectations, taking a progressively smaller share of national income every year since 1998. The sharpest percentage drop has occurred in manufacturing. But a decreasing proportion of national resources have been allocated for investment in private services since 1999 (see Table 17).

Table 17

Falling fixed national investment under New Labour

	Business Investment by Industry at Current Prices					
	Manufacturing		**Private Services**		**Total Business Investment**	
	£ billions	**% of GDP**	**£ billions**	**% of GDP**	**£ billions**	**% of GDP**
1998	20.5	2.4	71.7	8.3	107.6	12.5
1999	17.4	1.9	76.6	8.9	108.1	12.0
2000	17.6	1.8	80.0	8.4	109.8	11.6
2001	16.8	1.7	83.0	7.8	112.5	11.4
2002	14.6	1.4	77.4	7.4	104.5	10.0

Source: ONS, *Business Investment*, 23 August 2002 and 22 May 2003, Table 2; *Blue Book,* 2002 Table 1.2., and *UK output, income and expenditure*, 23 May 2000, Table C1.

Public sector investment has also declined in relative terms. Under the heading "Total Managed Expenditure" by the Government, the *Blue Book* reports that net public investment averaged only 0.7% of GDP from 1998-2001, compared with an average of 1.3% during the 1993-97 period. It is not surprising that, without substantial additions to physical capacity and new technology, the jump in total expenditure on public services has been largely absorbed by wage and other input cost inflation. This has benefited public sector employees and suppliers. But it has retarded increases in productivity and real output that would benefit customers and taxpayers by improving their access to public services (for example, by reducing hospital waiting times) as well as their quality (including lowering class sizes).

CHAPTER 7

TRAINING

Goals

Gordon Brown promised in his 1997 Budget Report that:

> The Government is committed to promoting investment in training… Future initiatives – including Individual Learning Accounts, Target 2000 and the University for Industry – will encourage companies and individuals to invest in training.

Results

The latest OECD data show that Government spending on labour market training amounted to only 0.16% of GDP in the UK in 2000, down from 0.22% during the last full year of Conservative Government, and less than half the German and French levels in 2000. Table 18 also shows that participant inflows into these training programmes in 2000 represented 1.5% of the total labour force in Britain, well short of the percentages for France (4.7%) and Sweden (2.8%).

Table 18

Low UK Training expenditure under New Labour

	Government Expenditure on Labour Market Training (% of GDP)		**Participant inflows (% of labour force)**	
	1996	**2000**	**1996**	**2000**
UK	0.22	0.16	2.0	1.5
US	0.04	0.04	0.7	1.1
Canada	0.26	0.18	2.2	1.6
Germany	0.46	0.35	2.2	1.8
France	0.55	0.43	5.4	4.7
Sweden	0.55	0.31	4.6	2.8

Source: OECD, *Employment Outlook,* June 2000 and July 2002, Annex Table H.

CHAPTER 8

EMPLOYMENT

Goals

Labour's 1997 Manifesto promised: "We will get the unemployed from welfare to work". In his 1997 Budget Report, Gordon Brown set out to raise employment levels by promoting a flexible and adaptable labour market. He would:

> …modernise the welfare state to help people to gain the skills and opportunities they need to play a full role in the modern economy, and have the right financial incentives to take up work.

The 1997 Budget also announced that Britain would take the lead in formulating employment promotion policies at the European level.

> It is unacceptable that over 18 million people remain unemployed across the European Union… Europe needs to do better at creating real and lasting jobs for all its people. That's why in June the Chancellor launched a UK action plan: Getting Europe to Work…The UK initiative sets a new agenda to increase employability and adaptability to change, and to include those currently excluded from the labour market.

Results

New Labour inherited the most flexible labour market in Europe. Britain had one of the highest proportions (72.5%) of the working age population in jobs in 1990 – far higher than the EU average of 61.4%. It was also slightly above the US percentage (72.2%). Britain's employment ratio had inevitably fallen during the 1991 recession and its aftermath (as it did in other European countries and the US following their recessions). But it had climbed back to 70.8% in 1997. This was 9.9 percentage points above the EU average in 1997 (see Table 19).

Table 19

Britain's static employment ratio under New Labour

	Employment/Population Ratios (% persons aged 15-64 years in work)					
	1990	**1997**	**1998**	**1999**	**2000**	**2001**
UK*	72.5	70.8	71.2	71.7	72.4	71.3
US*	72.2	73.5	73.8	73.9	74.1	73.1
Canada	70.3	68.0	68.9	70.1	71.1	70.9
Germany	64.1	63.8	64.7	65.4	66.3	65.9
France	59.9	58.9	59.4	59.8	61.1	62.0
Italy	52.6	51.6	52.2	52.9	53.9	54.9
Japan	68.6	70.0	69.5	68.9	68.9	68.8
EU	61.4	60.9	61.7	62.6	63.8	64.1
Total OECD	65.1	65.0	65.2	65.5	65.8	65.3

* Refers to persons aged 16 to 64.
Source: OECD, *Employment Outlook,* July 2002, Table B.

UK employment growth continued after the change of government, but the pace has slowed since 1999, giving a five-year average growth rate of 0.9% compared with 0.8% over the previous five years of Conservative Government. The latest ONS labour force survey (the Government's preferred source) records an increase in the total number of persons in employment of just 47,000 in the first quarter of 2003 over the previous quarter. With a growing population and labour force, the employment rate among those of working age levelled off at 74.6% in the first quarter of 2003, and was just 0.1% above the level reached two years earlier.[14]

Britain's current unemployment rate of 5.1% remains the same as two years ago, and is still above the rates reported for Switzerland (3.9%), Austria (4.3%) and Sweden (4.6%).[15] The number of unemployed males has climbed by 46,000 over the last two years. And Britain's official unemployment rate hides the amount of slack in the labour market. 7,687,000 people between the ages of 16 and 59 or 64 were recorded as being economically inactive in the first quarter of 2003.

Of course, many people are not actively seeking work (at least, work as defined in the official labour force surveys). Some people prefer to carry out family care responsibilities within the home, and share the income earned by other household members. Some are engaged in undeclared informal sector activities (such as odd jobs, house cleaning and baby-sitting). Others live

---

14 See ONS, *Labour Market Statistics,* 14 May 2003.

15 See *The Economist* 7 June 2003.

from criminal activities and are not recorded among the employed. Many people are too handicapped (mentally or physically) to work. But the high and relatively static proportion of people in work indicates that there are limits to the effectiveness of Government welfare-to-work programmes and tax credits. The rate and level of employment creation depends largely on the dynamism of the private market economy.

Table 20 details the number of work force jobs created or lost over the last 33 months. The total number of jobs went up by just 1% from June 2000 to March 2003. Sharp job losses were recorded in agriculture and fishing (-17.7%) and manufacturing (-11.1%). And job creation in the previously booming sector of finance and business services has slowed to a trickle since mid-2001. Britain's largest bank, HSBC, has just announced (on 2 July 2003) 1,400 job cuts, which it blames on rising employer NI contributions and increasing government regulation. The transport and communications sector has also shed jobs since June 2001.

Table 20

More jobs in the public sector, fewer in the private sector

	'000s of jobs by industry				
	June 2000	**June 2001**	**June 2002**	**March 2003**	**June 2000 to March 2003 % change**
Agriculture & fishing	504	461	422	415	-17.7
Energy & water	196	218	217	208	6.1
Manufacturing	4,246	4,054	3,880	3,781	-11.1
Construction	1,886	1,858	1,868	1,935	2.3
Distribution, hotels & restaurants	6,713	6,795	6,800	6,863	2.2
Transport & communications	1,746	1,814	1,805	1,809	2.2
Finance & business services	5,465	5,709	5,680	5,712	4.5
Public admin., education & health	6,797	6,868	6,974	7,094	4.4
Other services	1,745	1,737	1,805	1,785	2.3
ALL JOBS	**29,299**	**29,513**	**29,507**	**29,602**	**1.0**

Source: ONS, *Labour Market Statistics*, October 2002 and June 2003, Table 5.

Public services are now the only field in which significant numbers of new work places are being generated. Jobs in the private sector as a whole are shrinking, which is hardly the sign of a dynamic, competitive economy. The latest labour force survey data released by ONS show that in the three months to April 2003, the unemployment rate rose by 0.1% to 5.1%. There was a fall of 69,000 full-time workers to 20.66 million, and total hours worked were down by 1.4 million. The claimant count of the unemployed rose by 9,700 in May 2003, the largest monthly rise since December 1992.

EMPLOYMENT

On the wider pan-Europe front, Gordon Brown's much touted action plan "Getting Europe to Work" has had little or no impact. Despite New Labour's claim to be "at the heart of Europe", it has been unable to persuade the major EU members to reform their labour legislation to make labour markets more flexible. In response to a more buoyant global economy towards the end of the 1990s, the Euro-zone unemployment rate fell from 10.9% in 1997 to 8.0% in 2001. But structural rigidities were not tackled. So slower GDP growth in the first years of the new millennium has been followed by rising unemployment, up to 8.8% in May 2003 from 8.3% in 2002. Among under-25s, the rate has reached 17.0%.

CHAPTER 9

PRODUCTIVITY

Goals

The 1997 Manifesto insisted that "business can and must succeed in raising productivity". The Chancellor's 1997 Budget aimed:

> …to close the productivity gap by increasing the capital stock per worker and creating the conditions for applying capital and labour more efficiently.

Productivity has become one of Gordon Brown's dominant themes in successive Budgets. In the 1999 Red Book, for example, he stated:

> Raising productivity is the key to high rates of growth in people's incomes… The UK's productivity lags behind other major economies and has done for decades. This Government is determined to tackle the gap.

Results

The gap between productivity levels in Britain and its OECD competitors narrowed from 1979 to 1997. Real GDP per person employed in Britain rose at an average annual rate of 1.9% from 1979 to 1989, compared with 1.5% in Germany, 1.2% in the US, 0.9% in Canada and a Euro zone average of 1.8%. The UK maintained a 1.8% productivity growth rate from 1989-97, topping all the G7 countries except Italy and above the average for the Euro zone of 1.6%. (see Table 21).

Table 21

Improving UK productivity 1979 to 1997

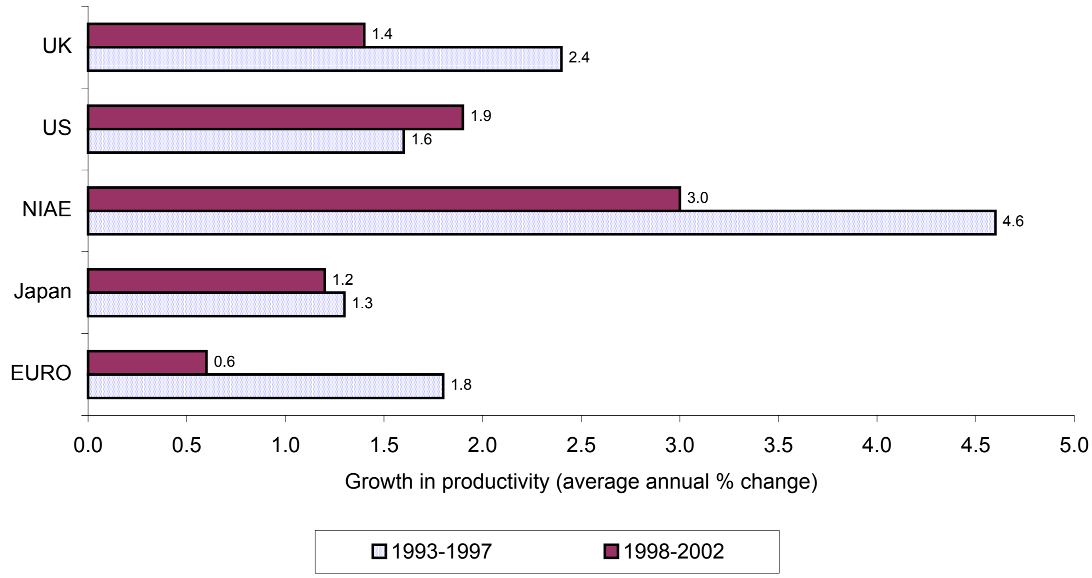
	Growth of real GDP per person employed (average annual percentage change)			
	1970-1973	**1973-1979**	**1979-1989**	**1989-1997**
UK	3.8	1.3	1.9	1.8
US	2.3	0.6	1.2	1.6
Canada	2.6	0.6	0.9	1.1
Germany	3.4	2.7	1.5	1.4.
EURO	4.2	2.5	1.8	1.6
Japan	5.8	2.8	2.6	1.5

Source: OECD, *Historical Statistics,* 2000, Table 3.7.

More recent data reported by the IMF indicate that Britain's productivity growth rate has dropped from an average of 2.4% during the previous Conservative Government to 1.4% under Labour. This was still better than the poor performance of the Euro zone and Japan (see Chart 9). However, it lags behind the average rate of the NIAE countries.

Chart 9

Slowing UK productivity growth 1998 to 2003



Sources: IMF, *World Economic Outlook,* September 2001 and April 2003, Statistical Appendix, derived from Tables 2 and 4.

Unfortunately for Britain's competitiveness, while productivity growth has slowed, labour costs have accelerated under the present Government. According to Eurostat, nominal unit labour costs rose at an average annual rate of 3.3% between 1998 and 2002, compared with a 1.3% average rate from 1993-97 inclusive. Over the last five years Britain's unit labour costs have risen substantially faster than any of its main competitors (see Table 22).

Taking exchange rate movements into account, Britain's relative unit labour costs jumped by 38% from 1996 to 2000, while the average for the euro area dropped by 17%.[16]

[16] See OECD, *Economic Outlook*, December 2002, Table 44.

Table 22

Higher UK Labour Costs under New Labour

	Nominal Unit Labour Costs (% annual change)				
	1962-1971	**1972-1981**	**1982-1991**	**1993-1997**	**1998-2002**
UK	4.5	14.5	6.1	1.3	3.3
US	3.1	7.3	3.6	1.3	1.4
Germany	4.3	5.2	1.8	2.0	0.9
France	4.6	11.1	4.1	1.2	0.5
Italy	5.4	16.5	8.7	2.5	0.5
Euro	4.9	9.9	4.4	1.3	1.4
Japan	5.3	8.5	0.8	0.0	-1.6

Source: Eurostat, *EU Statistical Pocket Book*, No. 9, 2002, Table 15.

CHAPTER 10

R&D

Goals

In its 1997 Manifesto, New Labour boasted that "Labour is the pioneer of new thinking" and promised:

> We support a collaborative approach between researchers and business, spreading the use of new technology and good design, and exploiting our own inventions to boost business in the UK.

The 1997 Budget Report continued in the same vein:

> The Government recognises the key contribution that investment in innovation and technology can make to growth and competitiveness. It has started an audit of its role in driving forward the Foresight programme, which aims to improve collaboration between business and the science base and to identify areas for investment for the future.

Results

According to the World Bank, total expenditure on R&D in the UK amounted to 1.8% of its Gross National Income in 2000, down from 2.2% in 1995.[17] Britain's 2000 R&D spending ratio was substantially below those of Japan (2.8%), the US (2.5%), Germany (2.3%) and France (2.2%) – see Table 23. Britain also had fewer scientists and engineers (per million people) working on R&D than these countries in 2000. Britain's receipts from royalty and licence fees more than doubled from $3.1 billion in 1990 to $6.9 billion in 1997. But the rate of increase has slowed under Labour. Receipts reached $7.3 billion in 2000.

---

17 R&D is defined as current and capital expenditures on creative, systematic activity that increases the stock of knowledge. Included are fundamental and applied research and experimental development work leading to new devices, products or processes.

Table 23

Falling Research and Development expenditure under New Labour

	Expenditure for R&D % of GNI		Scientists & engineers in R&D Per million people		Technicians in R&D Per million people		High-technology exports in $billions		Royalty and licence fee receipts in $billions	
	1995	**2000**	**1995**	**2000**	**1995**	**2000**	**1997**	**2001**	**1997**	**2001**
UK	2.2	1.8	2,417	2,678	1,019	1,014	95.8	67.4	6.9	7.9
US	2.5	2.5	3,732	4,103	n.a.	n.a.	197.7	178.9	33.7	38.7
Canada	1.6	1.7	2,656	3,009	1,073	1,171	33.1	27.0	n.a	1.5
Germany	2.4	2.3	2,843	2873	1,472	1,362	112.2	86.0	3.2	3.1
France	2.4	2.2	2,584	2,686	2,874	2,878	68.7	67.2	2.0	2.5
Italy	1.1	1.0	1,325	1,322	800	806	32.7	21.5	0.5	0.4
Japan	2.9	2.8	6,309	4,960	828	663	152.4	99.4	7.3	10.5

Sources: World Bank, *World Development Indicators,* 1999, 2002 and 2003, Table 5.12.

Another disturbing trend is the decline in Britain's high technology exports.[18] They include aerospace products, computers, pharmaceuticals, scientific instruments, and electrical machinery. In 2001, UK exports of high technology products totalled $67.4 billion, a drop of $30 billion from 1997, and were well below the levels of the US ($178.9 billion), Japan ($99.4 billion) and Germany ($85.9 billion). However most advanced countries lost market share to the newly industrialising counties of Asia.

A further indicator of Britain's weakening technological edge is declining output in the engineering industries, which are the source of "embodied" innovation and technical know-how. Total turnover (in current prices) fell by 6.7% in 2001 from 2000, and was below the 1997 level. In the first eight months of 2002, output was 16.5% down on the same period of 2001. Turnover in the previously buoyant sector specialising in the manufacture of electrical and optical equipment (which includes telecom equipment and computer chips) tumbled by 22.2% from January to August 2002, after sliding by 10.9% in 2001. A recent press release issued by ONS in May 2003 shows that the turnover of producers of this category of equipment fell by 17.7% in 2002 (in constant prices), and the slide continued in the first quarter of 2003, with a 2.6% drop over the same period a year ago. Export turnover has dropped 8.8% so far this year, while new orders are down 6.5%.

---

18 These are defined by the World Bank as products with a high R&D intensity.

Table 24

Declining Engineering Industries under New Labour

Turnover in the UK Engineering Industries (values in current prices)

	Total engineering		Manufacture of Machinery and Equipment		Manufacture of Electrical and Optical Equipment	
	£ billions	**% change**	**£ billions**	**% change**	**£ billions**	**% change**
1997	91.5	-	33.4	-	58.1	-
1998	91.7	0.2	33.3	-0.3	58.4	0.5
1999	92.8	1.2	31.5	-5.4	61.3	5.0
2000	97.4	4.9	31.3	-0.6	66.2	8.0
2001	90.9	-6.7	31.9	1.9	59.0	-10.9
Jan-Aug 2001	61.7		21.3		40.6	
Jan-Aug 2002	51.5	-16.5	20.0	-6.1	31.6	-22.2

Source: ONS, *Engineering Turnover and Orders*, 2002, Tables ESO4, ESO5 and ESO6.

CHAPTER 11

REGULATION

Goals

The 1997 Budget promised to use a light regulatory hand:

> The Government wants regulation which is fair to both consumers and shareholders without discouraging managers from innovating and improving efficiency.

The Manifesto had already assured business people: "We will cut unnecessary red tape".

Results

The British Chambers of Commerce (BCC) compiled its first Burdens Barometer in 2000. It estimated that the total cost of regulation on business was £10 billion. In 2001, the BCC updated the estimate to £15 billion. The figures in Table 25 were compiled from Regulatory Impact Assessments that all government departments are required to complete. A Regulatory Impact Assessment sets out the risks, costs and benefits of any new regulatory proposal that has an impact on businesses. The Table gives the Government's own estimates of the compliance costs up to May 2002. Where the government's compliance cost assessments have given ballpark figures, the BCC has taken the median. No ex-post assessment has been made of whether these costs have been offset by higher labour productivity or greater enterprise efficiency overall. But the negative trends in the diverse economic indicators reviewed in this pamphlet suggest not.

Table 25

The Booming Cost of Red Tape under New Labour

Measure	Introduced	One-off admin costs	Recurring admin costs	Recurring financial costs	Updated total cost by May 2002
Trade Union Recognition	2000		£4 million		£8 million
Ordinary Maternity Leave	2000			£2 million	£7 million
Further Maternity leave	1999			£21 million	£50 million
Parental leave Extended to births before Dec 1999	1999 2001			£28 million £6 million-£39 million	£62 million £22 million
Right to time off for family or domestic grievances	1999			£6.9 million	£20 million
Right to be accompanied in dispute or grievance	2000		£2 million		£5 million
Part-time Workers Directive –includes Fixed term work	2000			£27 million £142-342 million	£306 million
National Minimum Wage	1999	£50-54 million	£85-330 million	See note*	£675 million
Stakeholder Pensions & Welfare Reform Bill	2001	£140 million	£15 million p.a. per million with s'holder pension		£314 million
Working time directive	1998			£1.8 billion to Nov. 98 £2.3 billion from Nov. 99	£7.65 billion
Working Families Tax Credit	2000	£40 million	£100 million		£256 million
Young People Time Off for Studying/Training	1999			£60-130 million	£273 million
Fire Precautions Regulations	1999	£2-28 million			£50 million
European Works Councils	1999		£15 million		£43 million
IR 35	2000	£18 million	£6 million	£475 million 00-01; £300 million thereafter	£524 million
Data Protection Directive 95/46/EC	1998	£836 million	£630 million		£3.1 billion
Investigatory Powers Act	2000				£40 million
Disability Discrimination Act		£180-225 million		£59- 265 million	£364 million
EU Pollution Directive 98/69/EC	2001			£980 million-£1.5 billion	£1.6 billion
TOTAL					**£15 billion**

* does not include the recurring financial cost per year of the NMW (£2.4 billion).
Source: British Chambers of Commerce, *Burdens Barometer,* 2001.

CHAPTER 12

ENTREPRENEURSHIP

Goals

New Labour set out a pro-business agenda in its 1997 Manifesto:

> New Labour offers business a new deal for the future. We will leave intact the main changes of the 1980s in industrial relations and enterprise. We see healthy profits as an essential motor of a dynamic market economy, and believe they depend on quality products, innovative entrepreneurs and skilled employees.

Gordon Brown kept to the same script. In his 1997 Budget Report, he said he would:

> Encourage entrepreneurial, outward-looking and internationally competitive businesses. Foster a flourishing small firms' sector by lowering taxes, improving capital allowances, improving the quality and effectiveness of business support, and ensuring cooperation with the banks, especially for high tech start-up companies.

The 1997 Red Book also announced a UK initiative that:

> …aims to build up small and medium sized enterprises through a task force whose aim is to cut bureaucracy, reduce costs on cross-border trade, open up new financing possibilities and provide training and information on the opportunities of the single market.

Results

Gordon Brown has delivered on his promise to reduce the rate of corporation tax on small and medium-sized enterprises (SMEs). But no data are available on their effective tax burden in relation to turnover or value-added. From the scanty information published, it does not look like expectations have been fulfilled. The Government's Small Business Service publishes periodic information on business start-ups and closures. The latest press release states there were 175,500 new VAT registrations per 10,000 resident adults in 2001, a 7.9% drop from 2000 and 3.9% down in the 1997 figure. But there were also 162,700 deregistrations per 10,000 adults in 2001. So the total stock of registered businesses at the end of 2001 was only 3.4% higher than in 1997.

Barclays Bank also keeps a record of business start-ups and closures. Its Small Business Survey for Quarter Two 2002 reported that some 82,000 new businesses started between April and June 2002, 8,500 fewer than in the first quarter. The number of businesses opening their doors for the first time was 11% down against the same period in 2001, and some 35% less than in the first quarter of 1999. Closures continued to increase in larger numbers than start-ups. 110,000 businesses ceased trading in Q2, 10% more than in the previous quarter, and 8% above the equivalent period in 2001. The net result was that the business stock declined by 27,500 firms. By mid 2002, England and Wales had 2.67 million businesses, the lowest stock since the first quarter of 1998.

Barclay's latest Small Business Survey for Quarter One 2003 noted a rising trend for business start-ups in the first months of this year. 107,000 firms opened their doors for business, 12% more than during the first quarter of 2002. But closures rose by 4%. So the total stock is now no higher than five years ago. And considering the squeeze on corporate profits and rising debt reported earlier, it is unlikely that the financial and economic health of small firms has been strengthened by Gordon Brown.

CHAPTER 13

INTERNATIONAL TRADE

Goals

The 1997 Manifesto pledged to "promote dynamic and competitive business and industry at home and abroad", accepting the importance of competitiveness and exports for Britain's future prosperity. Gordon Brown did not set any specific trade objectives in his 1997 Budget. But he emphasised that: "The Government wishes to encourage entrepreneurial, outward-looking and internationally competitive businesses".

The performance of British companies on world and domestic markets is an important indicator of the relative success or failure of his policies. A rising share of world exports would indicate increased competitiveness. So would a drop in its share of world imports, and a positive overall balance of trade (exports larger than imports).

Results

Britain's share of world exports of goods and services dropped to 5.0% in 2001 from 5.4% in 1997, according to the WTO (see Table 26). UK merchandise exports have fallen particularly sharply (from 5.2% to 4.4%).

Table 26

Falling Share of World Exports under New Labour

	Share in World Exports (in %)					
	Merchandise		Commercial		Total Exports	
	1997	2001	1997	2001	1997	2001
UK	5.2	4.4	6.5	7.4	5.4	5.0
US	12.6	11.9	17.5	18.1	13.6	13.1
Canada	3.9	4.2	2.2	2.4	3.6	3.9
Germany	9.4	9.3	5.7	5.5	8.7	8.5
France	5.3	5.2	6.1	5.5	5.5	5.3
Italy	4.4	3.9	5.5	3.9	4.6	3.9
Japan	7.7	6.6	5.2	4.4	7.1	6.1
WORLD	100	100	100	100	100	100

Source: WTO, *International Trade Statistics,* 1998, 2001 and 2002, Tables 1.5 and 1.7.

Britain's share of total world imports in 2001 (5.4%) was the same as in 1997, but in the field of commercial services its share jumped to 6.3% from 5.3% over this four-year period. This surprising trend indicates that foreign services suppliers found it easier to penetrate Britain's internal market.

Table 27

Static Share of World Imports under New Labour

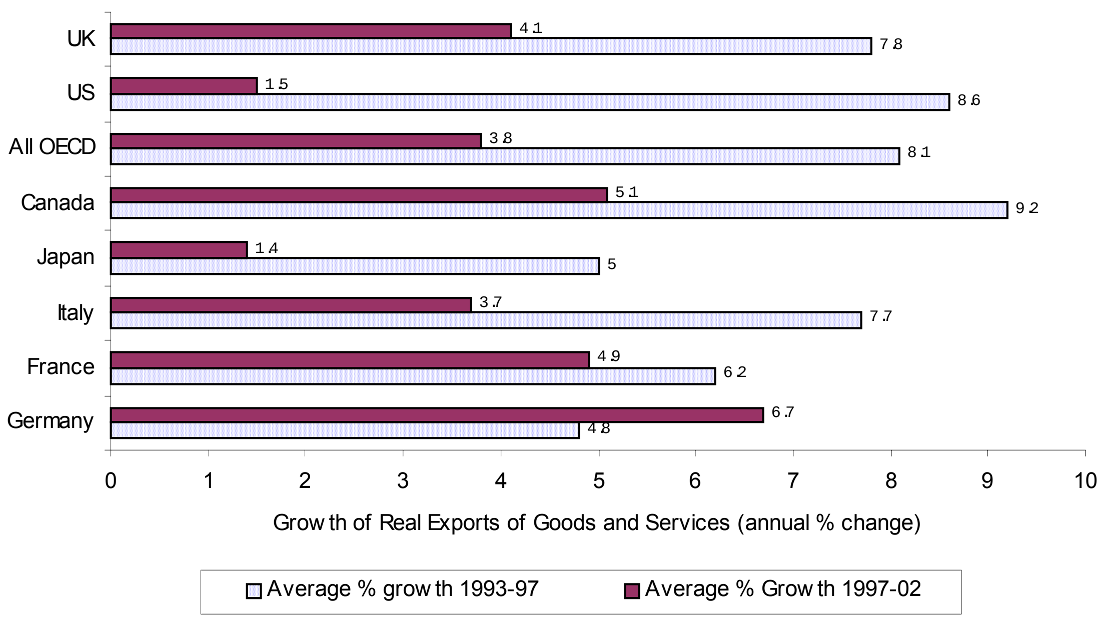
	Share in World Imports (in %)					
	Merchandise		Commercial		Total Imports	
	1997	2001	1997	2001	1997	2001
UK	5.5	5.2	5.3	6.3	5.4	5.4
US	16.0	18.3	11.6	13.0	15.1	17.3
Canada	3.6	3.5	2.8	2.9	3.4	3.4
Germany	7.8	7.7	9.3	9.2	8.1	7.9
France	4.8	5.1	4.8	4.3	4.8	4.9
Italy	3.7	3.6	5.4	3.9	4.0	3.7
Japan	6.0	5.4	9.4	7.4	6.6	5.8
WORLD	100	100	100	100	100	100

Source: WTO, *International Trade Statistics*, 1998, 2001 and 2002, Tables 1.5 and 1.7.

The real growth of Britain's exports of goods and services has averaged less than 1% annually over the last two years and 4.1% over the last five, compared with a 7.8% average rate from 1993-97 (see Chart 10). British exports grew faster than those of France and Germany during the last Conservative Government, but at a slower pace from 1998-2002.

Chart 10

Slow growth in Real Exports under New Labour



Note: Data for 2002 are projections.
Source: OECD, *Economic Outlook,* June 2002, Annex Table 9.

Britain's share of total world exports of manufactures fell by just 0.1 of a percentage point from 1990 to 1997, but by a full point (from 6.0% to 5.0%) over the next three years (see Table 28). Among G7 countries, only Canada resisted the competitive onslaught of Asia's newly industrialising economies. Three of them – China, Hong Kong and Korea – are now among the top ten exporters of manufactured goods. China's exports rose at a phenomenal average annual rate of 17% over the decade, compared with the US's 8% and Britain's 5%. However, Britain's manufactured exports contracted in 1998 and 1999. And in 2000 – when world exports soared by 10% – Britain's went up by a meagre 2%. (Comparable country data are not available for merchandise exports in 2001, although they are for exports of commercial services).

Table 28

Britain's Shrinking Share of Trade in Manufactures

	Value £ billion 2000	Share in world exports (%) 1990	1997	2000	Annual change (%) 1990-2000	1998	1999	2000
US	650.2	12.2	14.1	14.0	8	1	3	13
Germany	458.7	15.7	11.2	9.9	2	5	-1	-1
Japan	449.7	11.5	10.1	9.7	5	-8	8	14
France	245.0	6.7	5.6	5.3	4	8	-1	3
UK	229.6	6.1	6.0	5.0	5	-1	-3	2
China	219.9	1.9	4.0	4.7	17	3	7	28
Italy	209.9	6.2	5.4	4.5	4	2	-3	1
Hong Kong	192.5	1.1*	0.6*	0.5*	-2*	-10	-9	6
Canada	175.6	3.1	3.4	3.8	9	4	13	10
Korea	154.6	2.5	3.0	3.3	10	-3	13	20
WORLD	4,630	100.0	100.0	100.0	7	2	4	10

* domestic exports

Source: WTO, *International Trade Statistics,* 2001, Tables IV.28 and IV.30.

Britain's export performance in high-tech and skill-intensive areas of manufacturing has also been disappointing since 1997. Its share of world exports of machinery and transport equipment dropped by a full percentage point from 1997 to 2000, having remained stable at 6.2% from 1990 to 1997. It was unable to take full advantage of booming global demand in 1999 and 2000. World export growth for this type of manufactures accelerated to 6% and 11% in those two years respectively, but Britain's exports fell by 2% in 1999 and increased by just 4% in 2000. The pre-eminence of Germany, the top European exporter of machinery and transport equipment, suffered a severe set back. Its share collapsed to 10.6% in 2000, from 17.2% in 1990. The emergence of Mexico on the world scene is particularly noteworthy. Its exports in this field soared by 20% annually over the decade.

However, Britain's relatively weak performance in the booming world markets for high-tech products was compensated to some extent by an increased share of world exports of commercial services. Its share went up to 7.0% in 2000 from 6.5% in 1997. But services still only accounted for 26.1% of the UK's total exports in 2000. And its total trade gap widened sharply to £23 billion in 2001 (2.3% of GNI) from a virtual balance in 1997.

The picture becomes more mixed when individual branches of services are examined. Britain's share of world transportation exports dropped to 5.2% in 2001 from 5.7% in 1997, and it ran a trading deficit of $5.2 billion in 2001. Its exports fell by 8% in 2001, the second worst performance among the top ten exporters in this field.

Britain also did relatively badly in the field of travel. The most common goods and services covered are lodging, food and beverages, entertainment and transportation (within the economy visited), gifts and souvenirs. UK export earnings (from travellers visiting Britain) have declined in each of the past three years, including a huge drop of 16% in 2001, by far the worst record among the top ten countries in the travel field. Its share of world exports plummeted to 3.9% in 2001 from 4.8% in 1997. British travellers' spending abroad climbed rapidly however, and their share of world imports of travel services rocketed to 8.9% in 20001 (from 7.1% in 1997), leaving a trade deficit of $19.7 billion

The WTO groups the remaining forms of traded services under the heading Other Commercial Services. It covers the following components:

(i) communication services (telecoms postal and courier services);
(ii) construction services;
(iii) insurance services
(iv) financial services
(v) computer & information services (including news agency services);
(vi) royalties and licence fees;
(vii) other business services, comprising trade related services, operational leasing (rentals), and miscellaneous business, professional and technical services such as legal, accounting, management consulting, public relations services, advertising, market research and public opinion polling, research and development services, architectural, engineering. And other technical services, agricultural, mining and on-site processing;
(viii) personal, cultural, and recreational services including audio-visual services.

This group of services had a combined world export value of $655 billion in 2001. Britain was the second biggest player in 2001, with 11.1% of the market – up from 8.3% in 1997. It also matched America's growth from 1990-2001, averaging 10% annually. Its record was tarnished slightly during the final year of this period, however. It suffered a 2% fall in exports despite continued global expansion. Nevertheless, Britain still enjoyed a trade surplus for these services amounting to $41.7 billion in 2001

Despite its good performance in this last category of services, the net result of its total trade flows was a progressively wider balance of payments deficit. A positive balance for goods and services of £186 million in 1997 became a deficit of £22.5 billion in 2001, 2.3% of GDP.[19]

The latest trade data issued by ONS show no sign of improvement in Britain's competitiveness. The value of exports of goods excluding oil fell by 2% in 2002, and by 6.2% in the three months to May 2003 over the same period last year. And ONS disclosed that new estimates of the extent of VAT fraud on imports from the EU resulted in a substantially wider trading deficit for all goods and services in 2002, reaching $32.1 billion. In the three months ending in May 2003, exports of goods to the EU shrank by 14.9% in volume from March-May 2002. And Britain's world-wide exports of finished manufactures dropped by a huge 12.3% in the latest three months over a year ago. Britain still enjoyed a positive global trade balance in services amounting to £14.2 billion in 2002, but exports of services fell by 2.9% in the latest three months (March-May 2003) compared with the previous three months, and its trading surplus narrowed.[20]

The evidence is accumulating that, despite Gordon Brown's complacency, British competitiveness is being undermined.

---

19 ONS, *Blue Book,* 2002, Table 1.2.

20 See ONS, *UK Trade*, 9 July 2003.

CHAPTER 14

CONCLUSION

THE EVIDENCE SUGGESTS that much of the "golden economic legacy" that Gordon Brown inherited in 1997 is in danger of being frittered away. Growth is down – at a cost of income foregone of nearly £2,000 per household per year. Taxes are up (another £4,000 per household per year). Savings, investment and productivity growth are all down. Regulations are damaging business, with the rate of start-ups now at a worryingly low level. The balance of payments is deep in the red. Deflation is a real threat.

The blame for this record cannot legitimately be put at the feet of a "global downturn". Not every country has fared as poorly as the UK. The stock markets have clearly marked down Britain's competitiveness, with the FTSE-100 down 8% from the level of 1 May 1997. In comparison, the Dow Jones is up by 31% over the same period, the CAC-40 up by 21% while the DAX is at the same level it was six years ago.[21]

But it could be worse. Growth could be lower, taxes higher, competitiveness further undermined and deflation a reality (as opposed to just an all-too-likely possibility). And the Chancellor has paid back some of the national debt, given the Bank of England its independence and maintained at least some of Britain's labour market flexibility (at least relative to the Euro-zone countries).

But the outlook is bleak. GDP growth has stalled to 0.1% in the last quarter – yet government spending is set to soar by yet another £95 billion over the next three years.[22] The public services show little sign of responding to the vast new sums being spent. It is not surprising therefore that the Prime Minister, as well as other Cabinet Ministers, have all hinted recently that taxes will have to go up again. Surely under these circumstances business investment can only decline further, productivity growth be jeopardised, and Britain's competitiveness substantially undermined?

---

21 Figures as of 15 July 2003.

22 In 2002/03 Total Managed Expenditure was £421 billion. This will rise to £516.5 billion in 2005/06. Source: HM Treasury, *Red Book*, 2003, Table C11.

RECENT CENTRE FOR POLICY STUDIES PUBLICATIONS

The European Constitution by David Heathcoat-Amory MP (£7.50)
The political landscape of Europe is being transformed by the arrival of a new European Constitution. Many more decisions on foreign policy, criminal justice matters and economic and employment policies will in future be taken in Brussels, not Westminster. The new Union will have a permanent President and a Foreign Minister; the European Commission, the European Parliament, and the European Court of Justice will all gain new powers; national parliaments will be the losers. The author, who served on the Convention on the Future of Europe, shows how this represents a new constitutional order for the Union and its member states, with profound implications for parliamentary democracy and the principles of self-government. The author concludes that the British Government has no mandate to ratify such a major constitutional change without a referendum.

…a withering analysis of the draft – The Guardian

Paralysis or Power? The centre-right in the 21st century by Rupert Darwall (£7.50)
The great divide in British politics is now clearer than ever: the divide over the moral and practical case for the size of the state. Policies of tax and spend will not deliver. The examples of Canada, Australia, Holland and Ireland all suggest that reducing the proportion of GDP that is spent by the state can go hand in hand with both increased living standards and improved services. The centre right in Britain must reclaim a growth agenda and must argue for limited government.

Conservatives would do better by turning, once again, to the Centre for Policy Studies… Its latest pamphlet should be required reading for every Conservative MP –The Independent

Resuscitating the NHS: a consultant's view by Maurice Slevin (£7.50)
The NHS is imploding. Despite the substantial increase in funding over the last 10 years, there has been little improvement in patient care. And the further huge increases in NHS spending over the next five years will fail to produce the desired results. For waste and mismanagement are rife. Two key reforms are essential: the balance of power and control in the NHS must be taken from the bureaucracy, where it currently resides, and given to patients, where it belongs; and the number of managers and administrators in the NHS must be substantially reduced, thereby releasing funds to substantially increase the number and pay of nurses and allied professions.

Slevin's is one of the best researched and most eloquent versions – The Sunday Times

A SUBSCRIPTION TO THE CENTRE FOR POLICY STUDIES

The Centre for Policy Studies runs an Associate Membership Scheme which is available at £55.00 per year (or £50.00 if paid by bankers' order). Associates receive all publications and (whenever possible) reduced fees for conferences held by the Centre.

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