



Number 70

11 December 2015

Economic Bulletin

A MONTH OF POLITICAL FUDGE & INDECISION



- The electoral interests of public figures have led to dither and delay on vital policy issues.
- Electoral interests of Greek and German politicians will mean the Euro crisis persists.
- Re-commitment to ring-fencing some departmental expenditure appeases particular interest groups at expense of necessary spending adjustments.
- Decision on UK airport expansion is being led by political interests over economic interests.

1. PUBLIC CHOICE THEORY

Public Choice Theory advances the idea that politicians and officials are likely to develop public policy based on their own self-interest, rather than being motivated by the so-called “common good”. A handful of political developments over the past fortnight – domestic and European – appears to support this theory. The persistence of the Eurozone crisis, the re-commitment to ring-fencing certain items of public expenditure, the delayed decision on UK

Click [here](#) to subscribe to the CPS eNewsletter



airport expansion and local authority opposition to shale development all seem to be influenced, at least in some part, by public figures putting their own immediate self-interest ahead of the common good.

2. EUROZONE CRISIS

The Greek Parliament has recently approved a budget that implements a series of austerity measures as part of its bailout agreement. Despite these measures passing by a narrow majority in the Greek Parliament, the Greek crisis will not go away. The productivity gap between Germany and Greece remains a strain on the single currency, with GDP per hour worked in Germany at \$58.3 against Greece's \$34.5 per hour, according to the Organisation for Economic Co-Operation and Development. Furthermore, there are strong signs that the current deal will not result in a sustainable economic recovery for Greece. For example, Greece's unemployment rate of 25% has brought the viability of the pensions system into question and non-performing loans stand at a worrying rate of 48 per cent. The banking system is also bust: if a rich Greek uncle had given you €1,000 of shares in Piraeus Bank five years ago, they would now be worth 20 cents.

The persistence of the Greek debt crisis is the result of politicians in Greece and Germany putting the wishes of their respective electorates ahead of doing the right thing. This is public choice theory in action. Greece continues to suffer inside the Eurozone with no way out of its long-term crisis.

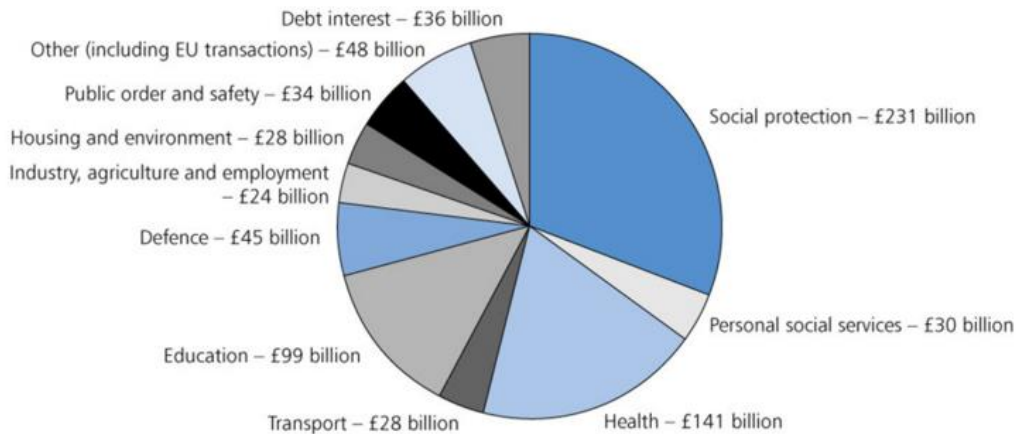
The election of Syriza in Greece arose from the population seeking Euro membership and a series of watered down bailout terms. In July 2015, an opinion poll showed that 84 per cent of Greeks wanted to keep the Euro against just 12 percent who wanted a return to the drachma. At the same time, 61 per cent rejected the bailout terms required to stay in the Euro in a referendum.

These demands from the Greek people are incompatible with hardened German attitudes, which have led to reluctance for substantial fiscal transfers and debt relief. 61% of Germans, 64% of Danes and 74% of Finns backed keeping the bailout terms as initially negotiated, according to a YouGov poll. These attitudes are inconsistent with International Monetary Fund analysis, which argues that significant debt relief for Greece is a necessity. These fundamental contradictions mean the Greek crisis is likely to persist into the future.



3. RING-FENCING OF PUBLIC EXPENDITURE

Figure 1: Government Spending by Expenditure Item



Source: *Summer Budget 2015*

In the [Autumn Statement 2015](#), the Government re-committed itself to ring-fencing large areas of public expenditure, including health, defence, international aid and pensioner benefits. The ring-fenced areas include £141 billion on the NHS, £153 billion on [pensions](#) and £45 billion on defence, limiting the Government's options in addressing the UK's budget deficit.

The ring-fencing of pensioner benefits includes the triple-lock on pensions, which has cross-party support. This policy ensures that the State pension increases by the highest of inflation, earnings or 2.5 per cent, placing a major burden on the Exchequer. A [report](#) by the Government Actuary's Department – published in error – projected that the government is spending an extra £6bn a year protecting pensioners' incomes.

The rationale behind protecting pensioner benefits at a time of public spending restraint is questionable, not least as pensioner wealth is rising faster than in other demographic groups. A likely rationale for the policy is linked to Public Choice theory. Pensioners are more likely to vote than their younger counterparts. In the general election 2015, 78% of those over 65 voted whereas only 43% of 18-24 year olds voted, according to [Ipsos Mori](#). This gives politicians an electoral interest in preserving benefits for pensioners.

4. DELAYED EXPANSION OF UK AVIATION CAPACITY

Yesterday's announcement that a decision on South-East airport expansion has been delayed also displays public choice theory at work. The benefits for the country as a whole are served by a prompt decision on Heathrow's expansion, but the electoral prospects of many politicians and political parties are served by delaying that decision. Similar political processes have occurred over the [previous decades](#). An early plan to expand Heathrow north of the Bath Road was abandoned in 1953. In the 1970s, the Third London Airport Commission recommended a new airport to the north east of London – a proposal that was subsequently shelved by the political class.

Click [here](#) to subscribe to the CPS eNewsletter



Figure 2: Economic Benefits of Heathrow over Gatwick

Heathrow Expansion	Gatwick Expansion
Would increase GDP by £131 - £147 billion.	Would increase GDP by only £89 billion.
Would generate 59-77,000 jobs for local people by 2030.	Would generate up to 32,000 jobs by 2050.
Currently has freight operations that deal with 17 times more tonnage than Gatwick.	“Gatwick’s position to the south of London limits its effectiveness as a national freight hub.”

Source: *Davies' Commission*

The economic case for expansion at Heathrow is compelling (see figure 2). The Davies' Commission – which was set up in 2012 and reported earlier this year – has stated that Heathrow’s hub status makes it well placed to cater for growing long-haul flying. The case for Heathrow expansion is also attractive from an industry perspective. 17 times more freight goes through Heathrow compared to Gatwick and 26% of all UK exports are currently routed via Heathrow. These potential benefits have led the CBI to highlight the potential harm that indecision over Heathrow expansion could pose for the UK economy.

Despite this pressing need for airport expansion, the Government has delayed a final decision for a further six months by highlighting concerns from the Environmental Audit Committee. Concerns on noise and emissions have already been addressed in the Davies’ Commission, which took nearly three years and £20m of public money to report. It is hard not to conclude the delayed decision is based on short-term political convenience rather than what is best for the country.

The current London Mayor Boris Johnson is against Heathrow expansion, along with the current Labour and Tory Mayoral candidates for the May 2016 election. Tory MPs representing seats in the south-west of London – some of whom sit as Ministers in the Government – are also set against Heathrow expansion. And, of course, back in 2009, David Cameron said “the third runway at Heathrow is not going ahead, no ifs, no buts.”

5. DELAYED DECISION MAKING ON SHALE EXPLORATION

In November, it was announced that the Department for Communities and Local Government will intervene in a planning decision relating to two shale applications in Lancashire. Despite this appearing to go against the Government’s localism agenda, the background of this case highlights why this was a necessary action. Public Choice theory has influenced local representatives, who appear to be acting in their own self-interest over the national interest.

Councillors on Lancashire County Council voted to oppose the shale exploratory applications after successful lobbying from green activists and some local residents. Despite claiming the

Click [here](#) to subscribe to the CPS eNewsletter



decision was based on environmental grounds, the council's own planning officers were clear that there were no reasonable environmental grounds to refuse the application.

This decision – seemingly motivated by political considerations – has led to a delay in shale exploration, which has the potential to provide huge economic benefits for the UK. The Lords Economic Affairs Committee, for example, highlighted the potential for indigenous shale to boost jobs in the north of England, enhance energy security, reduce the risk of gas price increases and assist struggling energy-intensive industries.

6. IF NOT NOW, WHEN?

In certain instances, short-term political considerations seem to be driving public policy decisions at the expense of the national interest. The Government's response to problems arising from public choice theory has been mixed. The launching of the Davies' Commission into airport expansion, which cost taxpayers £20m and took nearly three years to report, appears to have failed in its objective of removing political considerations from the decision. On the other hand, the Government's willingness to remove decision making powers on shale exploration applications from local authorities is likely to have more success.

Public choice theory will undoubtedly continue to influence politicians and political parties. However, sound decision making that provides economic benefits to the country collectively will always pay higher political dividends in the longer term. Rather than appeasing particular interest groups in specific areas of public policy, the Government should risk losing some short-term political popularity – particularly at this stage in the electoral cycle when they afford to do so.

Voters at a general election put a premium on the issue of economic competence. By sacrificing some political popularity in the short term, the Government could boost its popularity at a later stage in the political cycle when the economic benefits of decisions are realised.

7. MUST BE READ

- [How David Cameron can expand London's Heathrow Airport without breaking his third runway pledge](#) – City AM
- [Five ticking time-bombs keep Grexit on the radar](#) – Ekathimerini

8. MUST BE READ ON CAPX

- [Cameron's renegotiation "red card" demand is impossible](#) – Andrew Lilico
- [Letters to the Editor](#) – 10 Dec 2015

Daniel Mahoney and Tim Knox
Centre for Policy Studies

DISCLAIMER: The views set out in the 'Economic Bulletin' are those of the individual authors only and should not be taken to represent a corporate view of the Centre for Policy Studies

Click [here](#) to subscribe to the CPS eNewsletter