

Name:	Adrian Giurconiu
Registration Number:	0917585
Module:	EC 355 Public Economics
Topic:	<i>Outline and discuss recent (1999-present) trends in the size of government and the composition of government expenditure in the UK and ___ (choose another OECD country). Present the empirical evidence as clearly as possible, fully identifying your data sources.. To what extent has policy converged or diverged between these countries? What is responsible for these trends? Consider public choice and public interest arguments as well as changes in political/economic ideologies and philosophies.</i>
Country of Choice:	Ireland

1. Introduction

Given a choice of an OECD country to compare the United Kingdom to, Ireland seems a logical choice: each is the only country the other has a land border with; their political systems are rather similar¹; and they are two of the most economically free countries in the European Union².

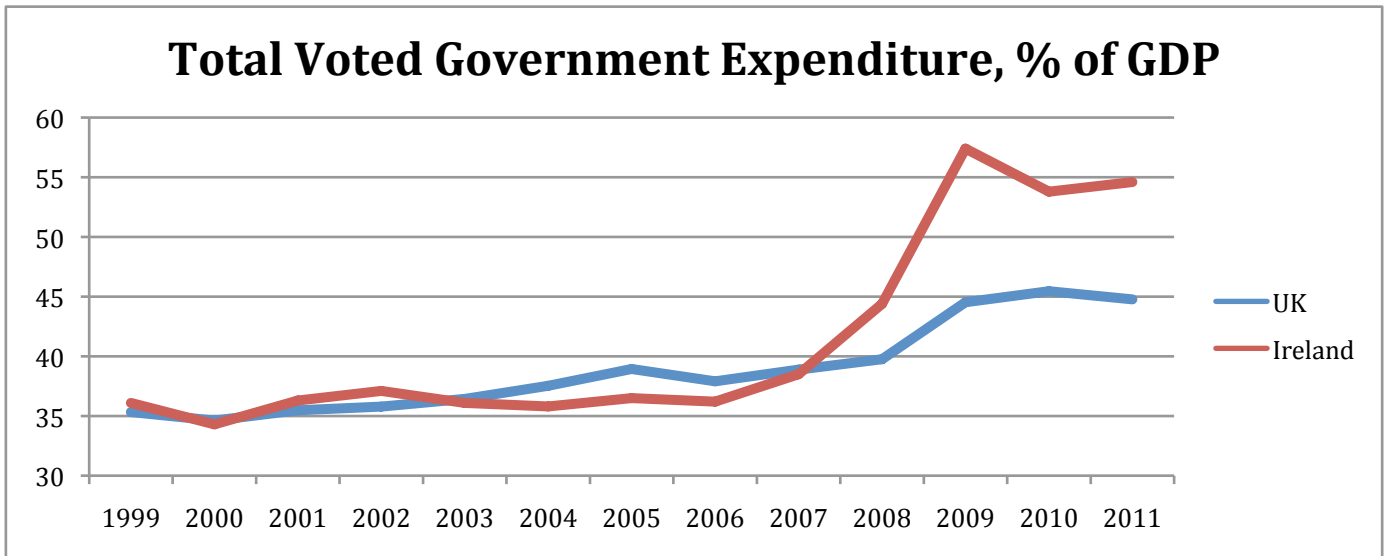
The question requires a comparison between the approach the governments of the two countries have chosen in regards to the way they have set public expenditure over the period since 1999. It also asks for a distinction between public choice and public interest, as well as between political ways of thinking. Most policy decisions are made with a mixture of public interest and choice in mind, so a distinction cannot be made unless a clear rift is visible. I have attempted to find such rifts by relating expenditure to exogenous variables that should clearly drive government policy. If policy takes a direction opposite to what the variable suggests it should, than public choice is definitely at work. This is a very simplistic approach but a more detailed one is beyond the scope of this paper. Party platforms (general ideology and pre-election manifestos) are also taken into consideration. No econometrics is used, as the data sets are very small, and depicting data in chart format should be enough.

The paper first takes a look at the overall picture regarding public spending in the two countries. Then, the change in a series of spending items is analyzed: welfare, education, health, defence, transport, protection and pensions, focused on the period 1999-2008. Subsequently the way spending was adjusted in UK and Ireland in reaction to the financial crisis is compared.

¹ Ireland has a parliamentary system of government with the Prime minister being the de facto head of state, a bicameral parliament with one elected chamber and one named and similar political parties to the UK ones – US Department of State website.

² Heritage Foundation Index of Economic Freedom: Ireland is first in EU, UK is fourth.

2. General



Sources: UKPublicSpending.co.uk; Irish Government Financial Accounts (Finance.gov.ie)

The chart above shows us two countries with an average public spending level. Ireland's was very level throughout most of the examined period (1999-2008). This goes against the view of public spending as a luxury good, as the Irish economy was going through a remarkable boom, with rapidly improving living standards. We can actually observe the beginning of an increase in 2007, before the financial crisis, which maybe shows a preference for bigger government.

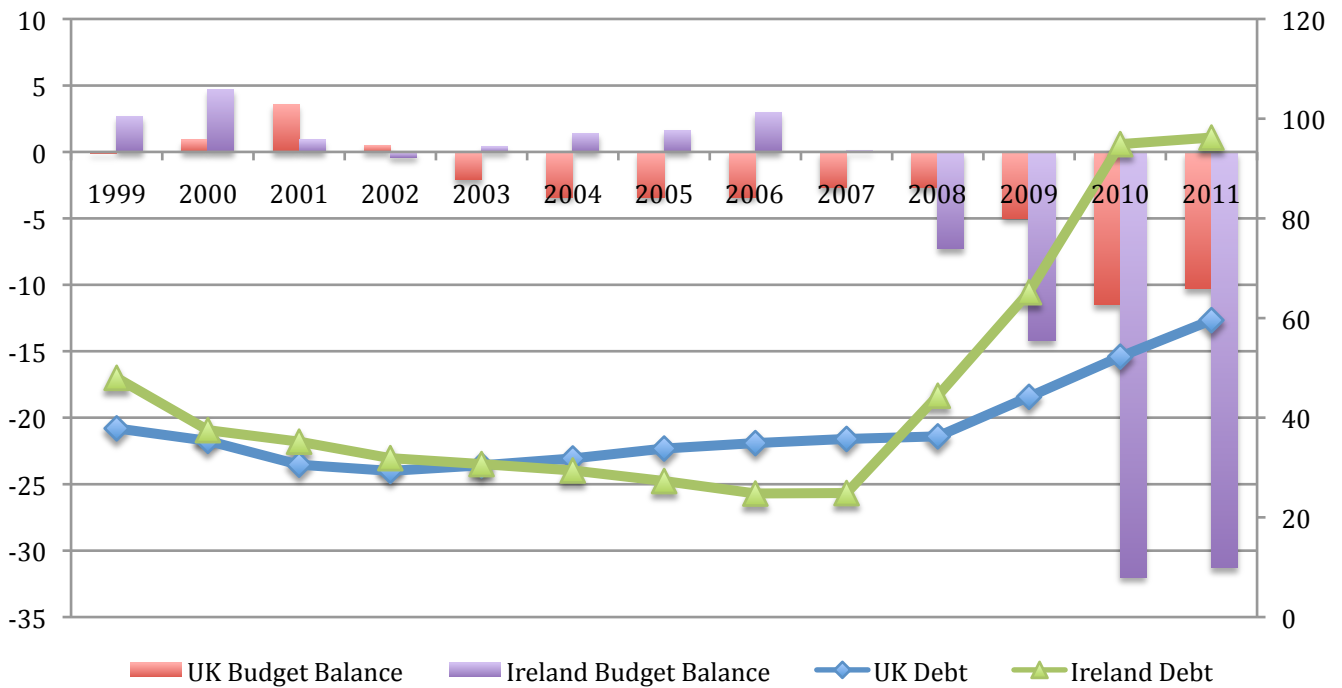
UK exhibited a slight increasing trend until 2008, not unexpected given a continuous period of centre-left government.

2009 saw a sharp increase in public expenditure as a response to recession. Ireland's small and open economy turned out to be the more vulnerable of the two, and despite the stronger injection it suffered worse from the crisis.

Stimulus added a lot to public expenditure, while the drop in output meant a major drop in tax intake. The following graph shows the massive increase in budget deficit both countries had to endure. However, relatively Ireland's deficit were disproportionately higher. The country had to deal with an enormous housing bubble bursting and, just like the UK, it bailed out its banking sector. But with a small GDP and banks that leveraged worldwide, this meant a meteoric rise in public debt relative to GDP. All in all, fiscally Ireland suffered far more from the crisis.

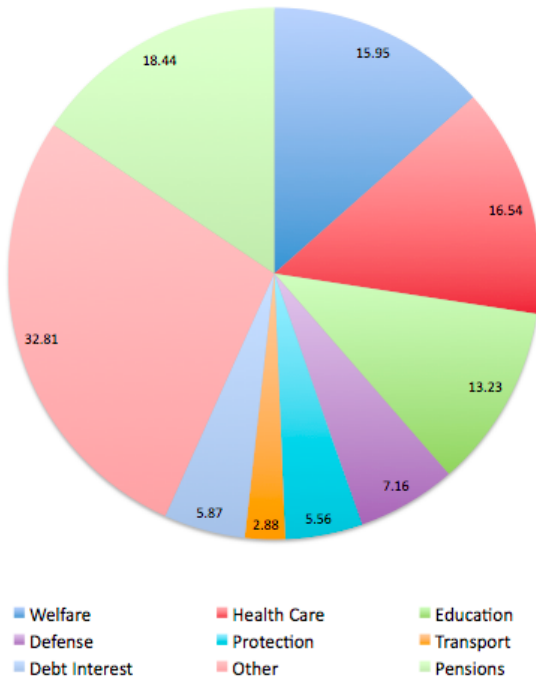
Up until then, it had been the more 'responsible' of the two nations, as far as balancing the budget is concerned. We can see that besides a modest deficit of 0.4% of GDP in 2002, Ireland had consistent budget surpluses and it had paid half of its public debt, taking down from 48% of GDP in 1999 to 24.9% in 2007. By contrast, UK ran deficits from 2003, expanding its welfare state.

UK & Ireland Budget Balance and Public Debt, % of GDP

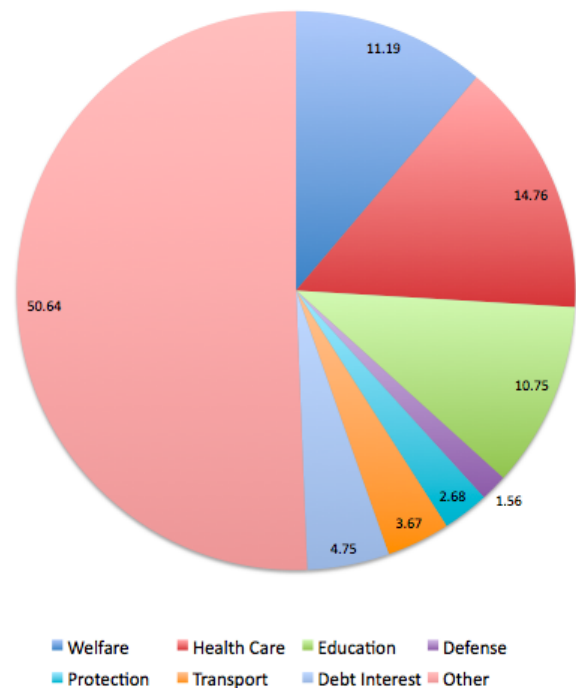


Sources: Irish Government Financial Accounts (Finance.gov.ie); TradingEconomics.com

UK Public Spending 1999-2011



Ireland Public Spending 1999-2011



Sources: UKPublicSpending.co.uk; Irish Government Financial Accounts (Finance.gov.ie); TradingEconomics.com (for Ireland interest spending 1999-2010)

So what have the two governments spent the money on? The previous double graph shows the average percentage of public expenditure over the 1999-2011 period, where data was available, for a series of items. Different ways of defining these items may account for some differences. Furthermore, the data on UK was perfectly centralized while the data on Ireland came in a series of annual reports, organized by departments.³

The orders of magnitude for each of these items are comparable in the two countries, showing somewhat similar policies, but each of them individually (except Transportation) is higher in the case of UK. The composition of public expenditure changed over that period though, as well shall in the following sections.

As far as the political scene is concerned, both countries' politics were dominated through most of the studied period by one major party. Fianna Fail has held a near majority in the Irish Parliament until 2011 when it was voted out of power. The Labour Party in the UK held a majority until 2010. It is difficult to say how much party ideology has influenced public spending. It is true that the Labour Party is a centre-left party that promotes a big government, social safety nets, public investment, regulation etc. and UK under it has seen a higher level of spending than Ireland, who in turn saw the rule of Fianna Fail, a centrist party with no clear ideology, sharing the executive with the Progressive Democrat Party (until 2008), a centre-right party promoting market liberalism.

Normally it would be a good idea to check each party's election manifesto and according to votes, see what policies the public prefers. Unfortunately, in such rigid political climates this is difficult. One thing that is clear is that ideology lost a lot of ground to public interest in 2008. In the face of the crisis, all governments since (covering both sides of the political spectrum in both countries) have been forced to deal with falling output in 2008-2009 and budget deficits in 2010-2011.

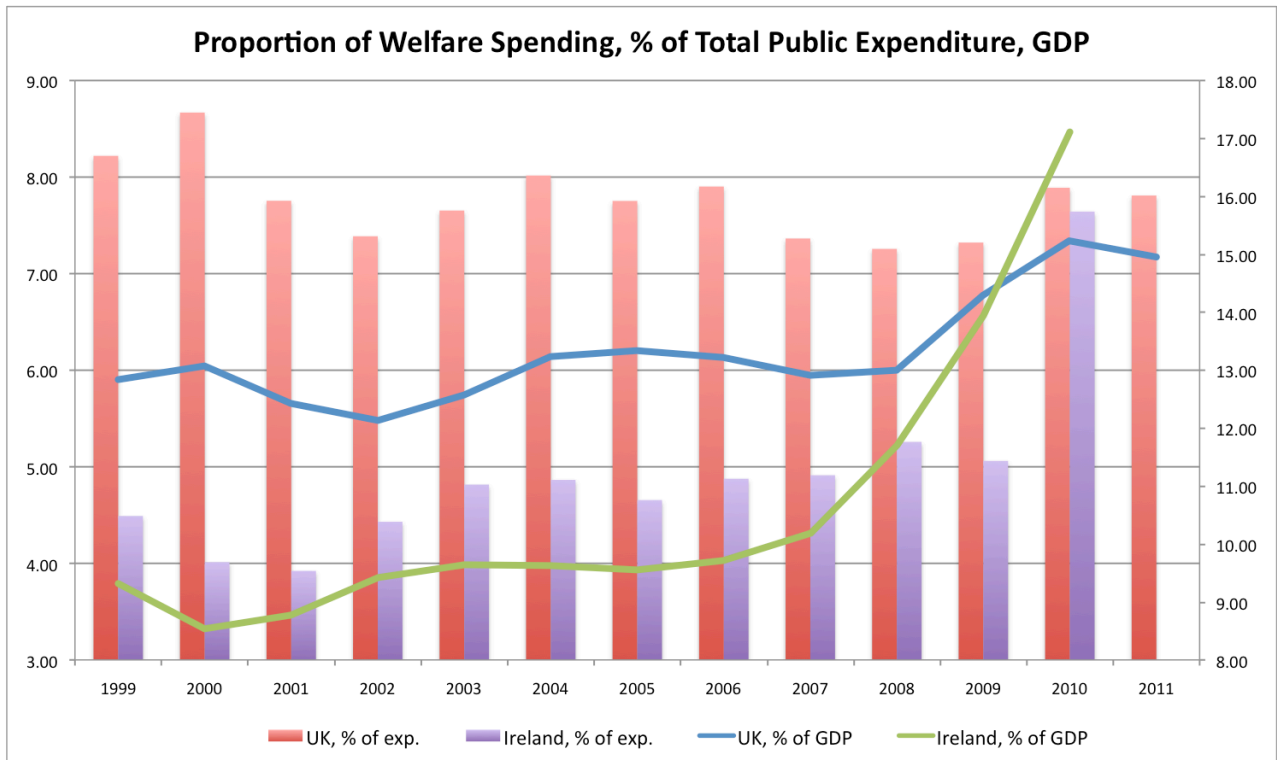
There are some agreements: the election manifestos for the 2002 elections in Ireland of the two parties that got most votes (Fianna Fail and Fine Gael) both make a big issue out of responsible spending. We can see that the 2001 budget surplus had decreased a lot from the previous year and 2002 saw a deficit. The importance of this issue can be noted from the fact that Ireland only had surpluses for the next five years. The impact of ideology can be better noticed in the following general elections when Fianna Fail was focused on economic growth, while Fine Gael was promoting budget responsibility. The voter

³ I have defined the following for Ireland: Welfare is the budget for Social, Community and Family Affairs, or Social Protection in 2010; Pensions was defined as Superannuation and Retired Allowances but the extremely low values, added to the fact that the bulk of state pensions is different administrative departments, making it impossible to collect is why pension spending in Ireland is not analyzed here; Health is the budget for Health and Children up to 2003, plus Health and Children and the separate Health Service Executive after 2004; Defense include Army Pensions; and Protection includes Police, Prisons and Courts budget; all budgets include both voted current expenditure and voted capital expenditure.

numbers gap between the two parties increased, and so did public spending in Ireland.

3. Welfare

Spending on welfare was on average 15.95% of government expenditure in UK and 11.19% in Ireland in the studied period. The following graphs shows the variation in the magnitude of this spending, both as a proportion of total public spending (right scale; columns), and as a proportion of GDP (left scale; lines):

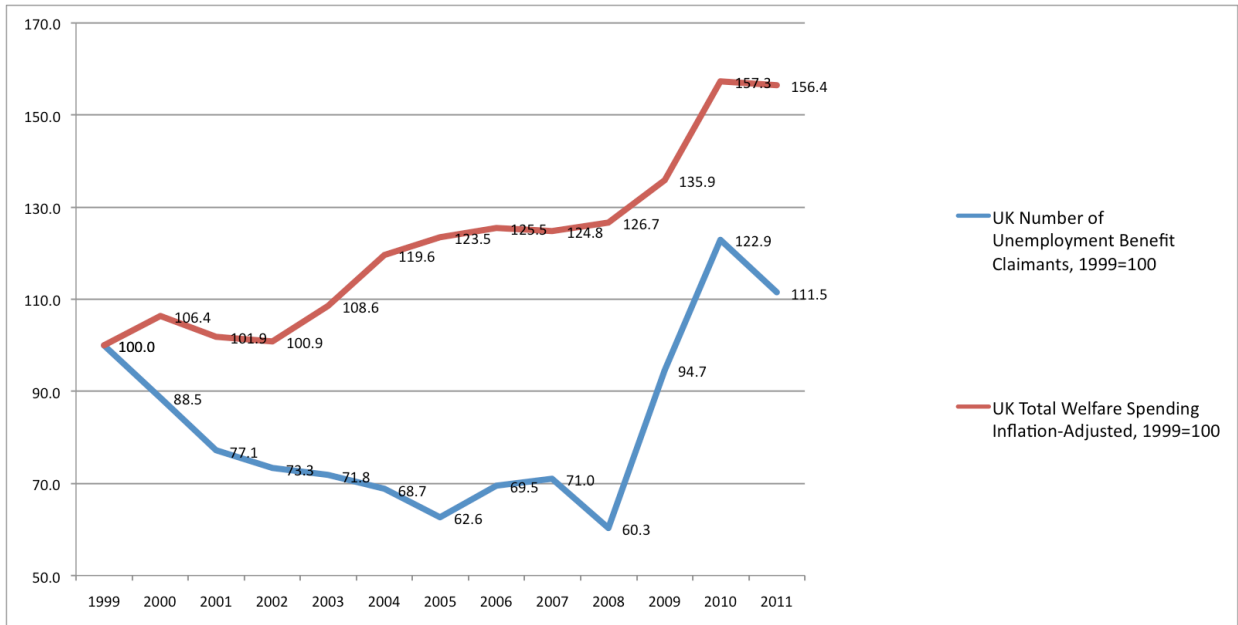


Sources: Irish Government Financial Accounts; UKPublicSpending.co.uk

UK consistently spent more on welfare until 2009, with a figure around 6% of GDP. It is noteworthy that during the 2001 recession welfare spending dropped, by both measures, increased later during an expansionary period and significantly more during the financial crisis (although it stayed reasonably low as a proportion of expenditure, as the government was forced into austerity in 2010-11).

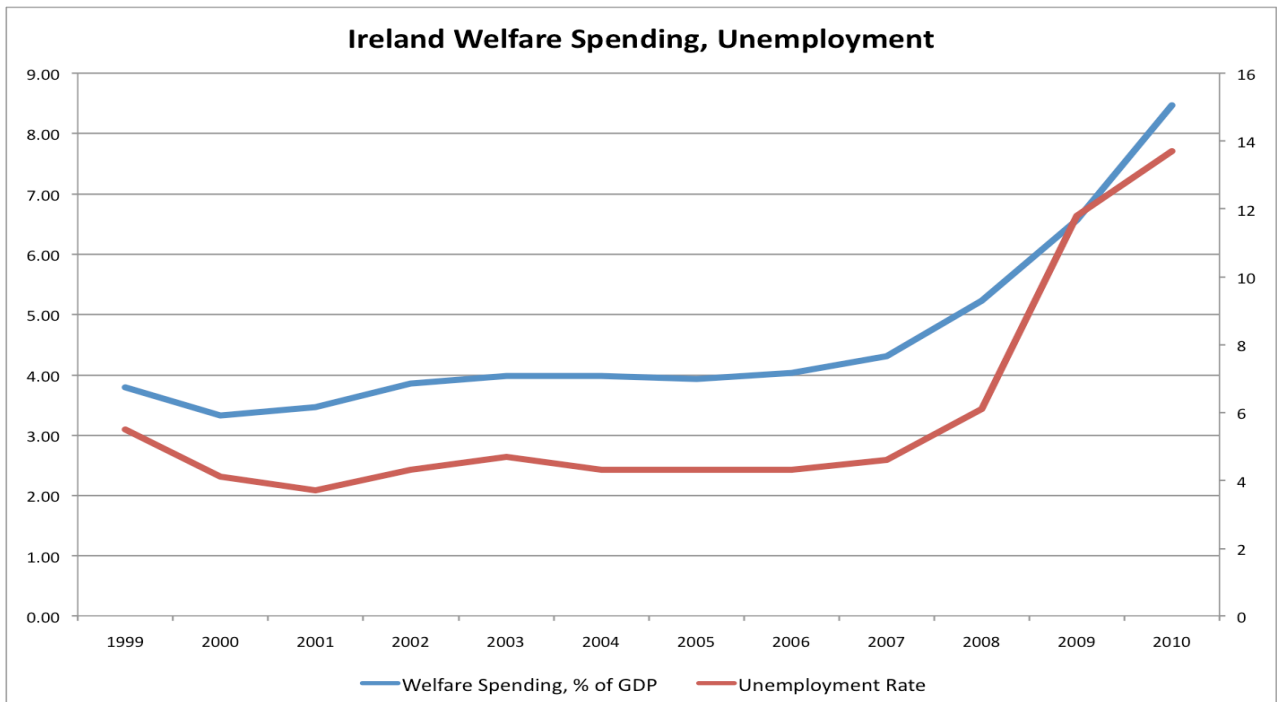
The Irish scenario was similar, with the latter phenomenon being much more pronounced. As previously mentioned, Ireland was forced to cope with an incredible manifestation of the crisis, and unemployment soared, with the number of recipients for welfare checks inflating massively.

It makes sense that a crisis forces a strong response but it does not say much about policy, because the decision makers' hands are tied, while policy is by definition a matter of choice. If policy were constant, total welfare spending should broadly move in line with unemployment. If it does not, it means that priorities have changed. A depiction of changes in unemployment and total welfare spending (adjusted for inflation) can shed light on that:



Sources: BBC; UKPublicSpending.co.uk

This graph, showing the change in the number of claimants of unemployment benefits, recorded in January each year versus the real change in total welfare spending shows the relation seldom holds in the UK. In five of those years, spending increased, even though the number of people receiving welfare decreased. In three more (2000, 2001, 2011) spending decreased slightly despite a significant drop in claimant numbers. When the number of claimants increased (2006, 2007, 2009, 2010), spending also increased but less than proportionally. This shows that the British state has had a strong welfare focus.

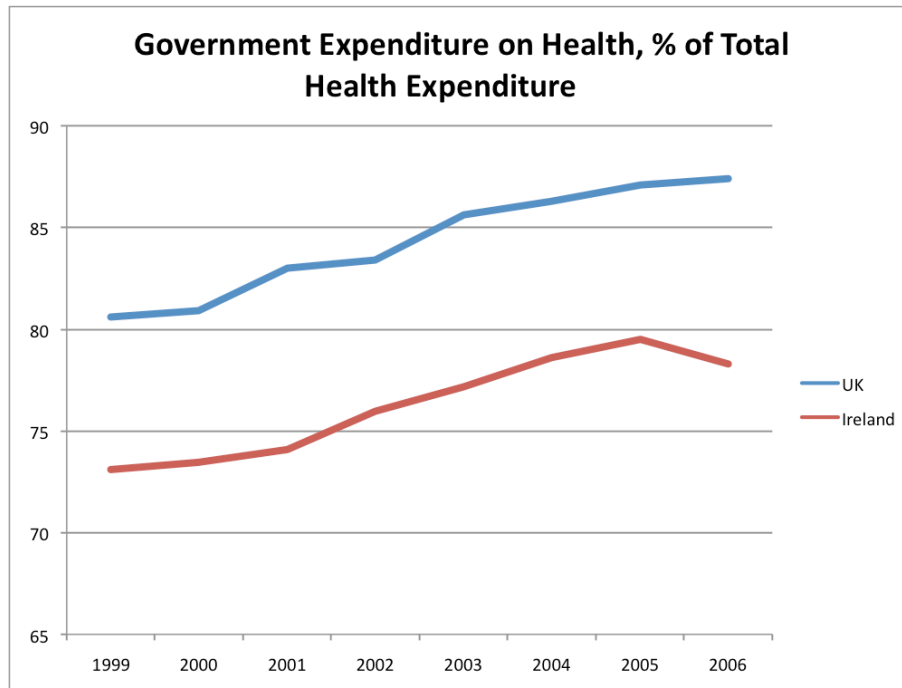


Sources: Irish Government Financial Accounts; IndexMundi.com

With Ireland, we see that the two figures are closely related. Only when unemployment (right axis) increased rapidly in 2009 and 2010, spending could not keep up and increased at a lower rate.

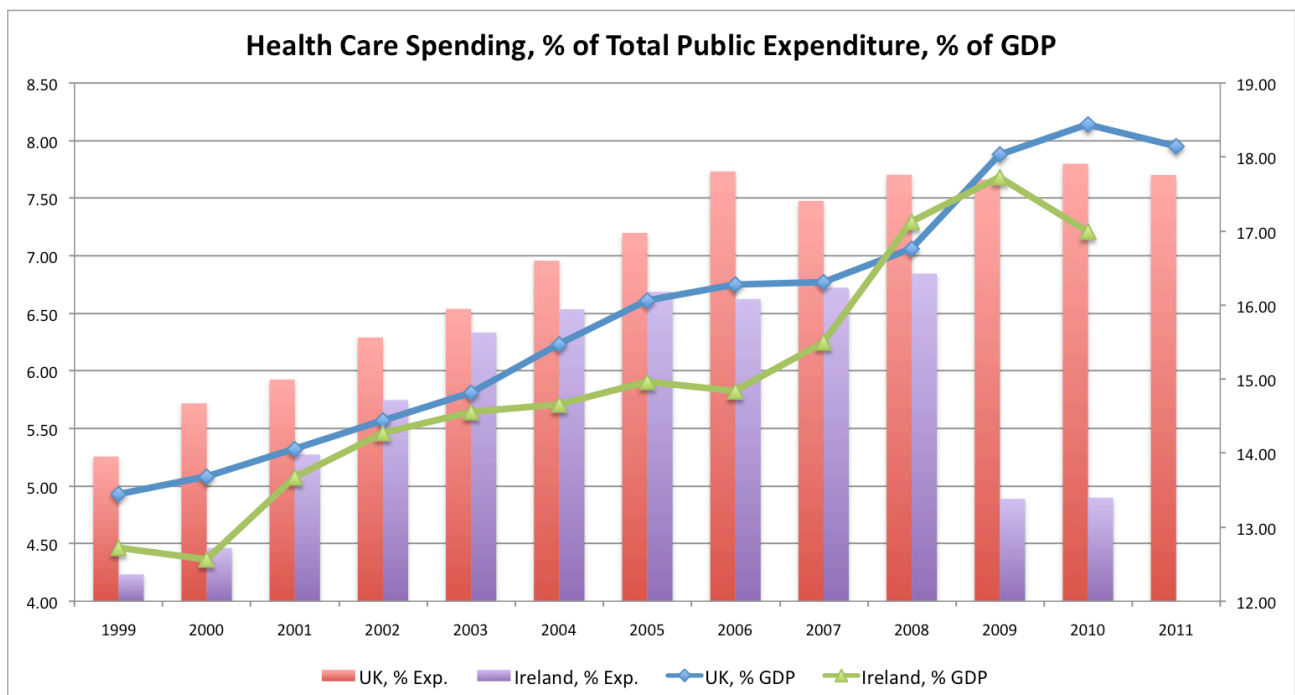
4. Health Care

In both countries there is universal health care coverage. The government offers free health care for residents, and indeed in both countries most health care is paid by the government:



Source: World Health Organisation

The next question is how has the importance of spending on health fluctuated:

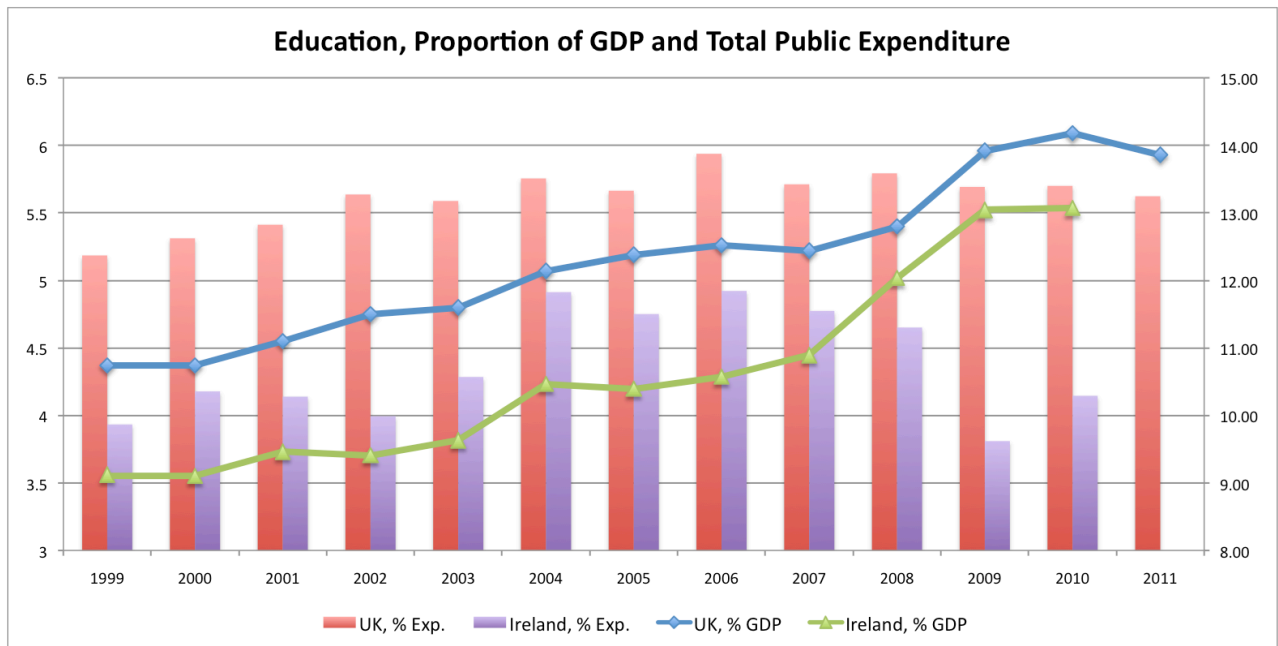


Sources: Sources: Irish Government Financial Accounts; UKPublicSpending.co.uk

The lines (left scale) show that health care spending increased as a proportion of GDP in both countries: steadily in UK, in leaps in Ireland. Relative to expenditure however, Ireland had almost converged with UK in 2005, but stagnated afterward while in UK the pace was kept for two more years.

As the debt crisis arose health spending was spared too much austerity in UK, dropping only slightly relative to GDP, but in Ireland it fell significantly. Strangely, it lost massive ground as a proportion of expenditure, from 16.4% to 13.4% from 2008 to 2009, even though health care provision is one of the most important functions of the government and it is an income-inelastic good.

5. Education

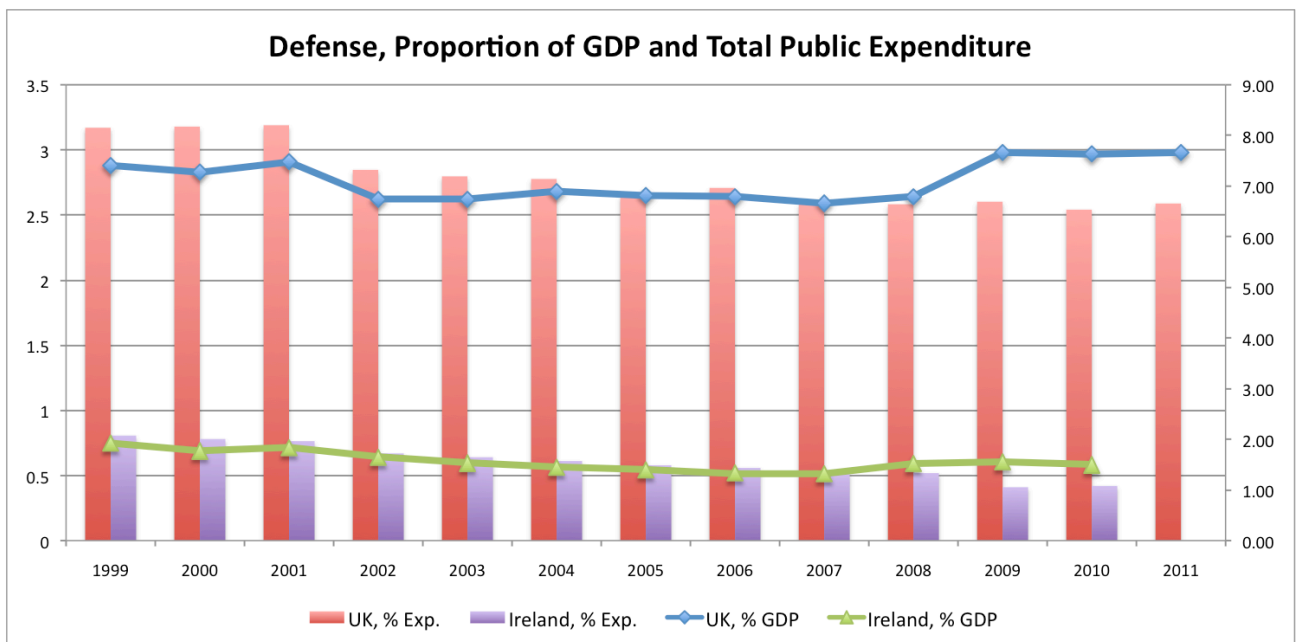


Sources: Irish Government Financial Accounts; UKPublicSpending.co.uk

In UK we see a very slight increasing trend up to 2004 to divert a higher proportion of public expenditure to education, after which it stabilizes. So for the most part, education spending relative to GDP has increased with total spending.

Ireland, as with the other expenditure items, spends less. A curious phenomenon is that the graph can be split into three periods when the share of the budget dedicated to education was stable: up to 2003, 2004-2008, and after 2009. It is worth noting that 2004 saw a reorganization: whereas up until 2003 there were three education subdepartments (dedicated to primary, secondary and tertiary education), each managing its own budget, 2004 saw bringing them all together under a single authority. As a proportion of GDP, education spending in Ireland has almost converged with that in UK.

6. Defence



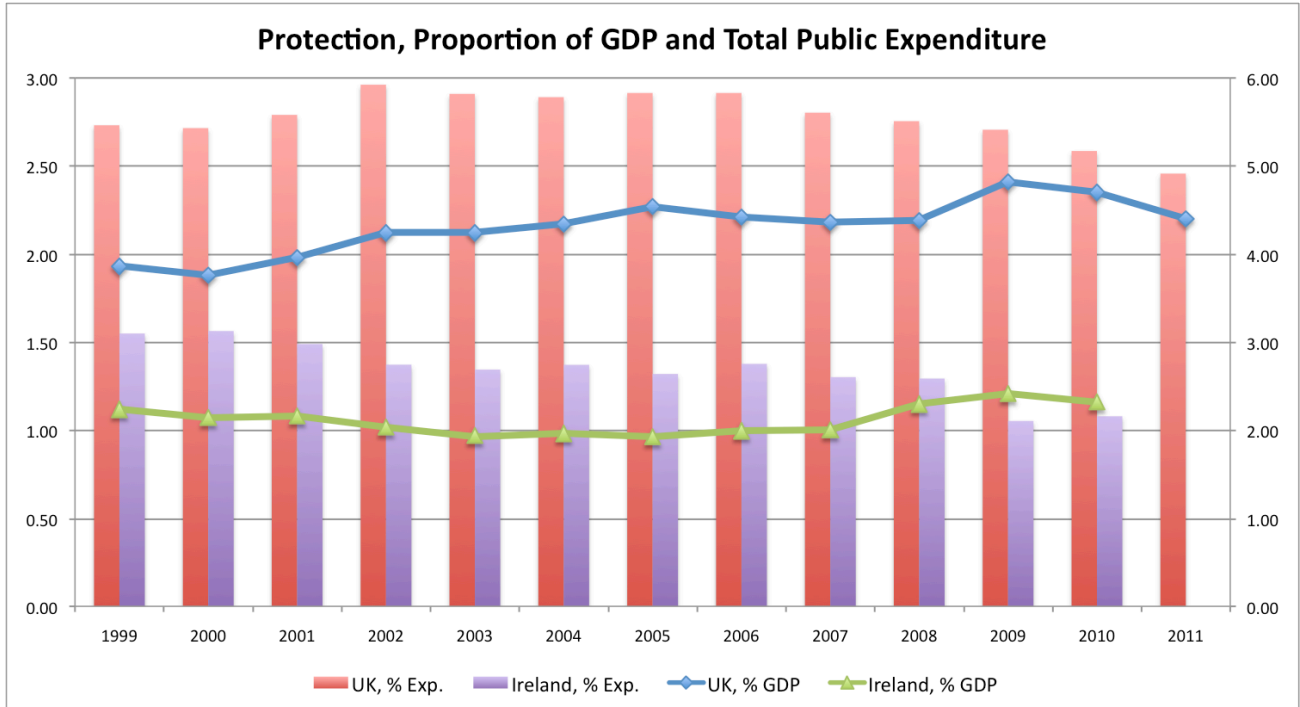
Sources: Irish Government Financial Accounts; UKPublicSpending.co.uk

With defence we see a massive difference. Ireland, a small country, not part of NATO, with no involvement in the wars in Kosovo, Afghanistan or Iraq, spends a minuscule amount on defence.

UK, on the other hand, not only part of NATO but also the UN Security Council is one of the world's greatest military powers, and it has had significant involvement in all three wars. What is worth noting is that 2002 saw a drop in military spending, despite the war in Afghanistan, while 2009 saw an increase maintained afterwards, despite the austerity measures.

7. Protection

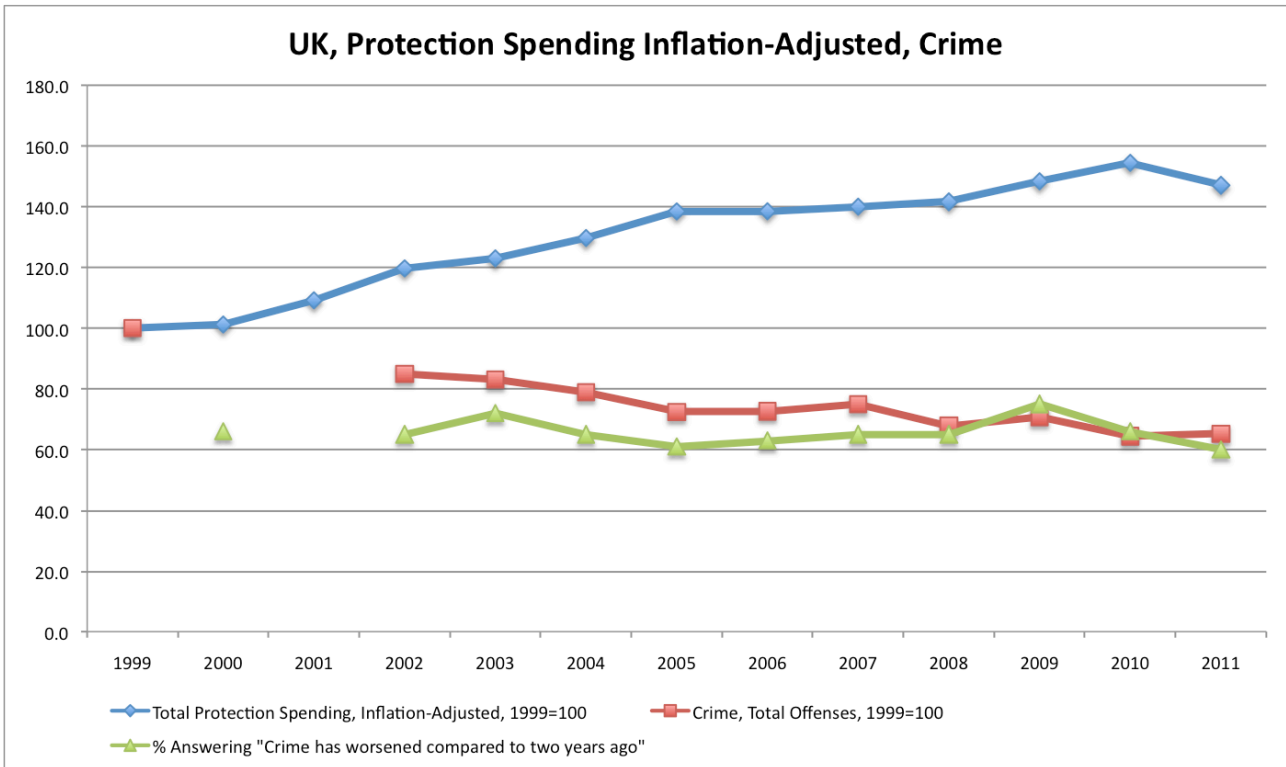
Public protection is one of the state's most important functions, and it is something taken very seriously by the public. It is also one that can be deeply affected by emotional arguments besting rational ones.



Sources: Irish Government Financial Accounts; UKPublicSpending.co.uk

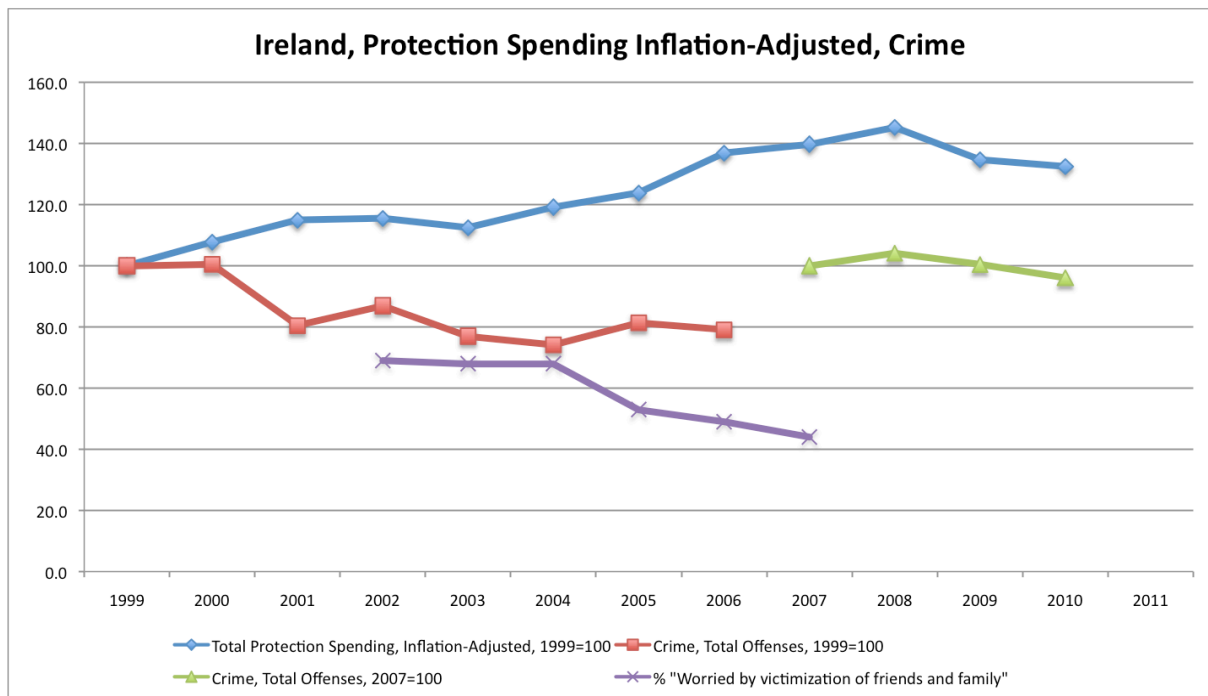
For the most part it has stuck to a fixed value. We see a very mild decreasing trend in both countries, relative to total spending, starting in 2007.

The question is, does the population pressure the government to react to crime according to reality or to perception? And does the government listen to facts or pressure? The following two graphs measure crime, perception of crime and government response in UK and Ireland. The numbers come from the British Crime Survey via The Guardian for UK, and from the Crime Council (1999-2006) and Central Statistics Office (2007-2010) for Ireland (note that the difference in the way data is collected and organised make for curious difference in the order of magnitude in crime numbers from 2006 to 2007).



Sources: UKPublicSpending.co.uk; The Guardian

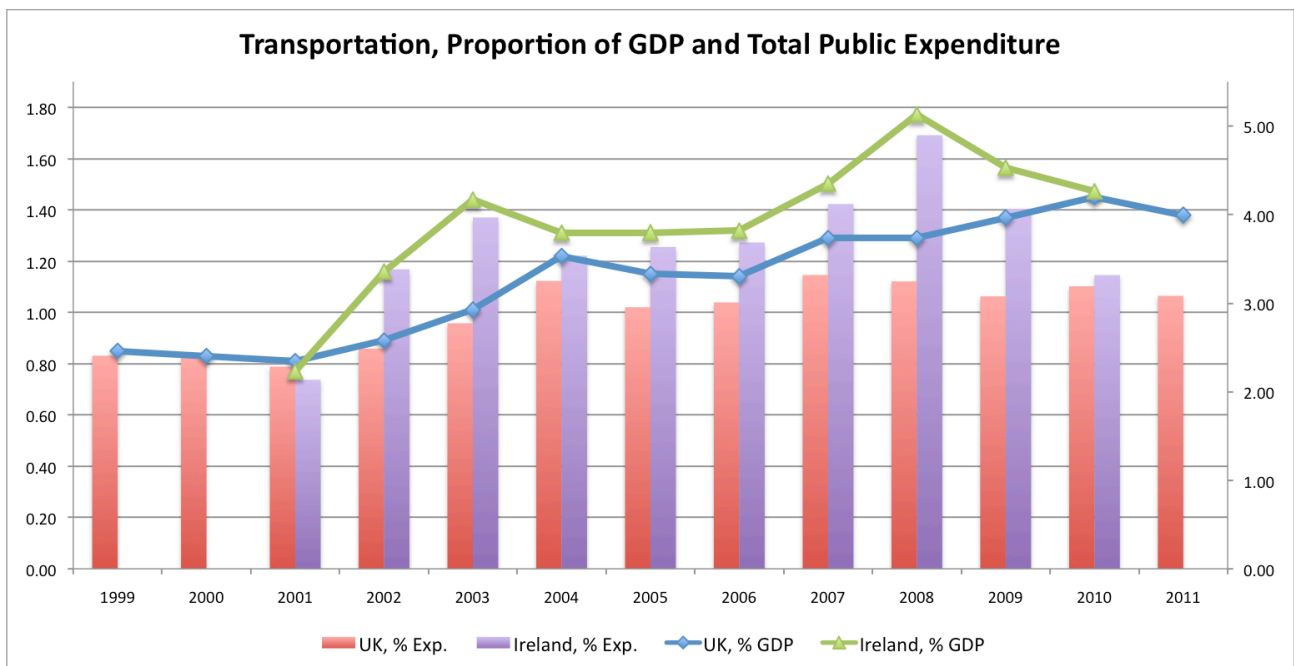
It is rather obvious that spending on fighting crime does not follow actual crime; quite the opposite: the figures diverge. However, the government's reaction to crime closely tracks (exception: 2004 and 2005) the public's (proven irrational) fear of crime. This is clearest manifestation of governing according to public choice.



Sources: Irish Government Financial Accounts; Central Statistics Office; Crime Council

With Ireland we have no immediately discernible connection between money spent on fighting crime and either crime or people's fear of it.

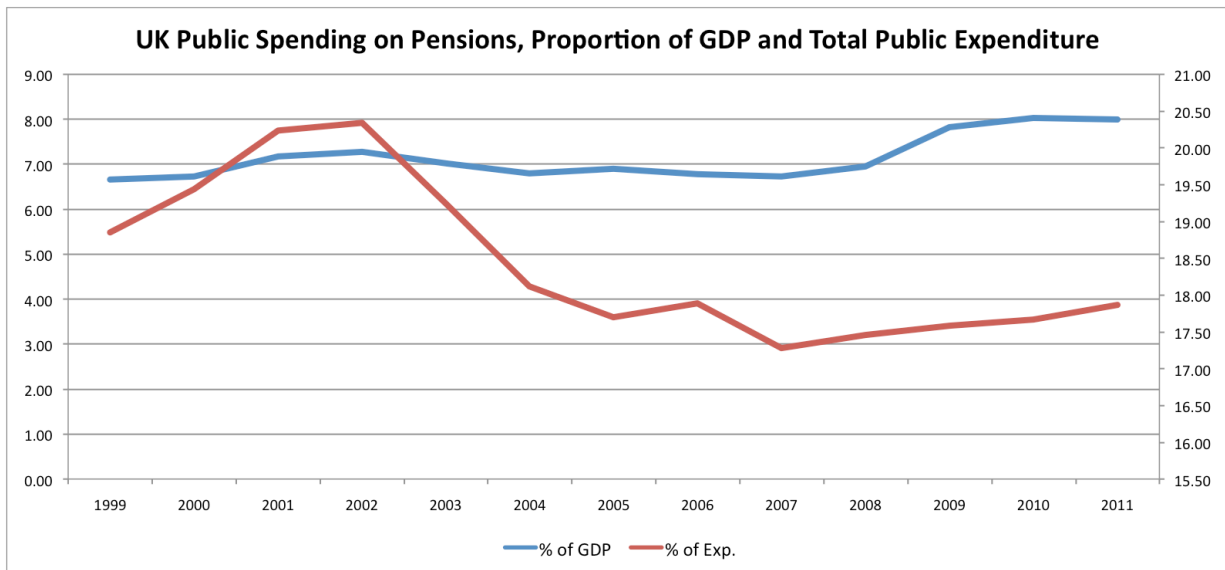
8. Transportation



Sources: Irish Government Financial Accounts; UKPublicSpending.co.uk

Transportation is the only spending item where Ireland has surpassed the UK since 1999. It makes sense that the Irish would invest more in their transportation infrastructure, since their economy has only recently (the 'Celtic Tiger' boom started in the late 80s) joined the developed economies. Less infrastructure capital means not only greater need for it, but also higher returns on investment.

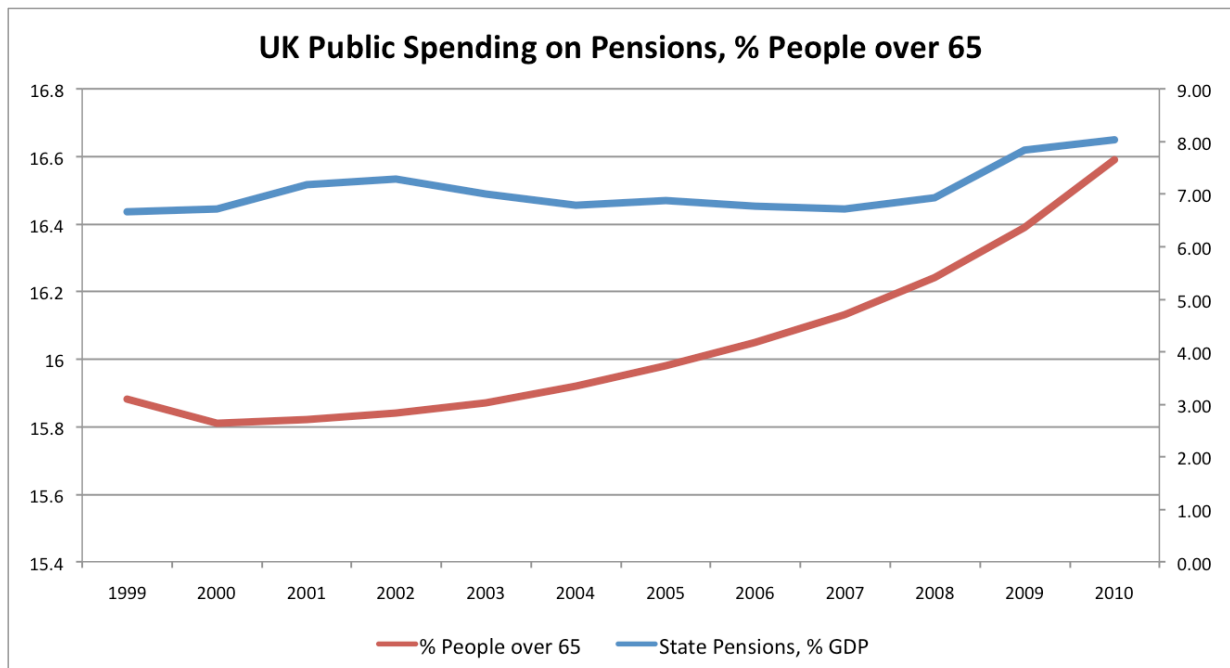
9. Pensions



Sources: UKPublicSpending.co.uk

Pensions have been the largest single item of expenditure in the UK budget since 1999. They have declined somewhat from a high of 20.5% in 2002, as a part of general spending. However, they have seen a rise as a percent of GDP since 2009, possibly as many people were forced into early retirement by the recession and later by austerity.

Pensions, we would expect to be related to the proportion of pensioners in the population. The problem is that, as this proportion increases, the political power of this group also increases, and they can pressure the government into spending more on pensions. So is the aging of the population related to spending?



Sources: UKPublicSpending.co.uk; TradingEconomics.com

The graph shows there is no connection between the two lines. Even though the population has clearly aged, the proportion of GDP awarded to state pension spending has stayed mostly constant.

10. Conclusion

The behaviour of the governments of the two countries have broadly been similar. Both focus on health care and welfare more than anything else (disregarding pensions). However, the UK has behaved much more like a welfare state.

UK public spending has not suffered very much from the financial crisis and austerity. Ireland by contrast has had to find major savings.

The evidence on whether government set the budget according to public interest or political pressure is mixed.

11. Data Sources

UK:

- UK Public Spending, **UKPublicSpending.co.uk**
- The Guardian, "Crime statistics for England & Wales: what's happening to each offence?", 14.07.2011, **<http://www.guardian.co.uk/news/datablog/2011/jul/14/crime-statistics-england-wales>**
- BBC, Economy Tracker, **<http://www.bbc.co.uk/news/10604117>**

Ireland:

- Department of Finance, Finance Accounts, **<http://finance.gov.ie/viewdoc.asp?DocID=-1&CatID=10&UserLang=EN&m=19>**
- National Crime Council, Crime Statistics, **http://www.crimecouncil.gov.ie/statistics_cri_crime_table3.html**
- Central Statistics Office, Crime and Justice Statistics, **<http://www.cso.ie/en/statistics/crimeandjustice/>**
- Department of Justice, Equality and Law Reform, "Fear of Crime in Ireland and its Impact on Quality of Life", Apr. 2009
- US Department of State, Bureau of Public Affairs: Electronic Information and Publications, Background Notes, Ireland, **<http://www.state.gov/r/pa/ei/bgn/3180.htm>**
- Irish Election Manifesto Archive, **michaelpidgeon.com/manifestos/**

General:

- Heritage Index of Economic Freedom: **<http://www.heritage.org/index/ranking>**
- Index Mundi, **IndexMundi.com**
- Inflation EU, **Inflation.eu**
- Trading Economics, **TradingEconomics.com**
- World Health Organization, Statistical Information System, **<http://apps.who.int/whosis/data/Search.jsp>**