Edexcel Economics A-level

Unit 4: The Global Economy

Topic 5: The Role of the State in the Macroeconomy

5.1 Public expenditure

Notes

Difference between capital expenditure, current expenditure and transfer payments

Current government expenditure is spending which recurs. This is on goods and services which are consumed and last for a short period of time. For example, it could be on drugs for the health service.

Capital government expenditure is spent on assets, which can be used multiple times. For example, it could be government expenditure on roads or building a school.

Transfer payments are welfare payments from the government. They aim to provide a minimum standard of living for those on low incomes. No goods or services are exchanged for transfer payments.

Examples of transfer payments in the UK include:

- Job Seeker's Allowance
- Income Support
- Child benefit
- The state pension

These are in place to ensure people have a basic standard of living and to help reduce the level of inequality in society. Transfer payments are a means for the government to redistribute income from the rich to the poor.

Reasons for the changing size and composition of public expenditure in a global context

In the UK, the government spends most of their budget on pensions and welfare benefits, followed by health and education. Income tax is the biggest source of tax revenue in the UK.

Education spending in the UK has remained relatively constant. This is because it is protected so it does not fall, but it also does not increase much either.

Social security payments are payments from the government to assist those who have low incomes. After the war, people saw this as necessary, so there has been a general increase in spending.

Defence spending in the UK is falling. This is the area the government spends least on.

The significance of differing levels of public expenditure as a proportion of GDP on:

- **Productivity and growth**

  Governments can spend money on supply-side policies to improve human capital and boost long run growth. Human capital is important for competitiveness. The government could invest in youth apprentice schemes, for example, to make people more employable and productive from a young age.

  Education and training can mean higher value products can be made and productivity can be improved.

  Fiscal policy aims to stimulate economic growth and stabilise the economy. The government could influence the size of the circular flow by changing the government budget, and spending and taxes can be targeted in areas which need stimulating.

- **Crowding out**

  Governments might have to fund its spending using taxes or running a budget deficit. This leaves fewer funds in the private sector for firms to use, since the government is borrowing money, which crowds them out of the market.

  When the government borrows a lot of money, interest rates might increase. This discourages spending and investment among the private sector.

  This reduction in private sector investment is the 'crowding out' of investment.

  Sometimes, crowding out refers to the government provision of a good or service, which would otherwise be provided by the private sector.

- **Level of taxation**

  The tax rate might increase if government debts get too high. If confidence is lost in the government's ability to repay the debt, governments might have to raise interest rates to encourage investors to buy bonds, so that they can finance the debt. It could lead to higher taxes and austerity measures, especially if the debt becomes uncontrollable.

In the UK, the size of government spending is about 40% of GDP. This means that citizens in the UK have a lower tax burden than in a country such as Switzerland, where government spending is 60% of GDP.

- **Equality and living standards**

Progressive taxes could be used to reduce inequality, since the poorest in society pay the smallest proportion of their income as tax. Redistributive policies and welfare payments, such as Income Support, could be used to help those on the lowest incomes.

Also, government spending on housing and the provision of public services, such as education and healthcare, helps provide equal opportunities for people from all income backgrounds. This ensures that even those on low incomes can afford a good standard of healthcare and education.

By providing these services, the government ensures that all members of society can achieve a minimum standard of living.