

Government Spending

Government spending, also known as public expenditure, is spending by the government on goods, services, investment and payments to households and firms.

For example total UK public expenditure stands at **£1,368 billion (44.8% of GDP)**.

Government spending can be divided into three main categories:

- Current expenditure
- Capital expenditure
- Transfer payments

Current Expenditure

Current expenditure is the day-to-day spending required to run the government and public sector.

Examples include:

- Wages and salaries of public-sector workers
- Medicines and other goods and services used by the NHS
- Running and maintaining government departments and public services

Current expenditure mainly maintains the existing provision of public services rather than directly increasing the economy's productive capacity.

For example current expenditure totals to **£523 billion** (~38% of total public expenditure), with public sector pay amounting to **£227 billion**.

Capital Expenditure

Capital expenditure is government spending on long-term investment in infrastructure and capital equipment.

Examples include:

- New hospitals and schools
- Roads and high-speed rail projects e.g HS2
- Other major infrastructure projects

Capital expenditure can increase the economy's productive capacity.

Better infrastructure, healthcare and education → increases physical and human capital → raises productivity → increases long-run economic growth.

For example , in the UK Capital investment totals **£157 billion** (~11% of public spending) .

Transfer Payments

Transfer payments are payments made by the government where no goods or services are received in return.

Examples include:

- Unemployment benefits
- Disability payments
- Pensions
- Subsidies to producers and consumers

Transfer payments do not directly contribute to GDP, as income is simply transferred from one group in the economy to another. However, they can redistribute income and provide financial support to households and firms.

For example Total UK welfare and benefit spending reached **£314.9 billion (10.7% of GDP)**.

Reasons for Changes in Public Expenditure

Changing Incomes

Lower-income countries tend to collect less tax revenue, limiting how much governments can spend.

Rising national income → higher tax revenues → greater government revenue → greater capacity to increase public expenditure.

As incomes rise, people may also demand a greater quantity and quality of public services, such as cleaner environments, recycling facilities and public amenities.

Ageing Population

Many developed economies have experienced falling birth rates alongside rising life expectancy, creating a larger ageing population.

Ageing population → more people receiving pensions + greater demand for healthcare + less income tax revenue → higher government expenditure on pensions and healthcare.

Economic Conditions

Government spending can change significantly in response to economic shocks.

During the 2008 Global Financial Crisis, UK government borrowing increased to finance higher spending and reduce the risk of a prolonged economic downturn.

In the years following the crisis, the government reduced expenditure and increased taxes as part of austerity.

Significance of Public Expenditure as a Proportion of GDP

Government spending as a proportion of GDP varies significantly between countries.

In 2020, public expenditure represented approximately:

- 51.44% of Sweden's GDP
- 40% of UK GDP
- 25.37% of Thailand's GDP

Different levels of public expenditure can affect productivity and economic growth, living standards, x out, taxation and equality.

Productivity and Economic Growth

Better education and healthcare → improves human capital → workers become more productive → productive capacity increases → greater long-run economic growth.

Better infrastructure → lowers firms' costs + improves efficiency → increases productive capacity → greater long-run economic growth.

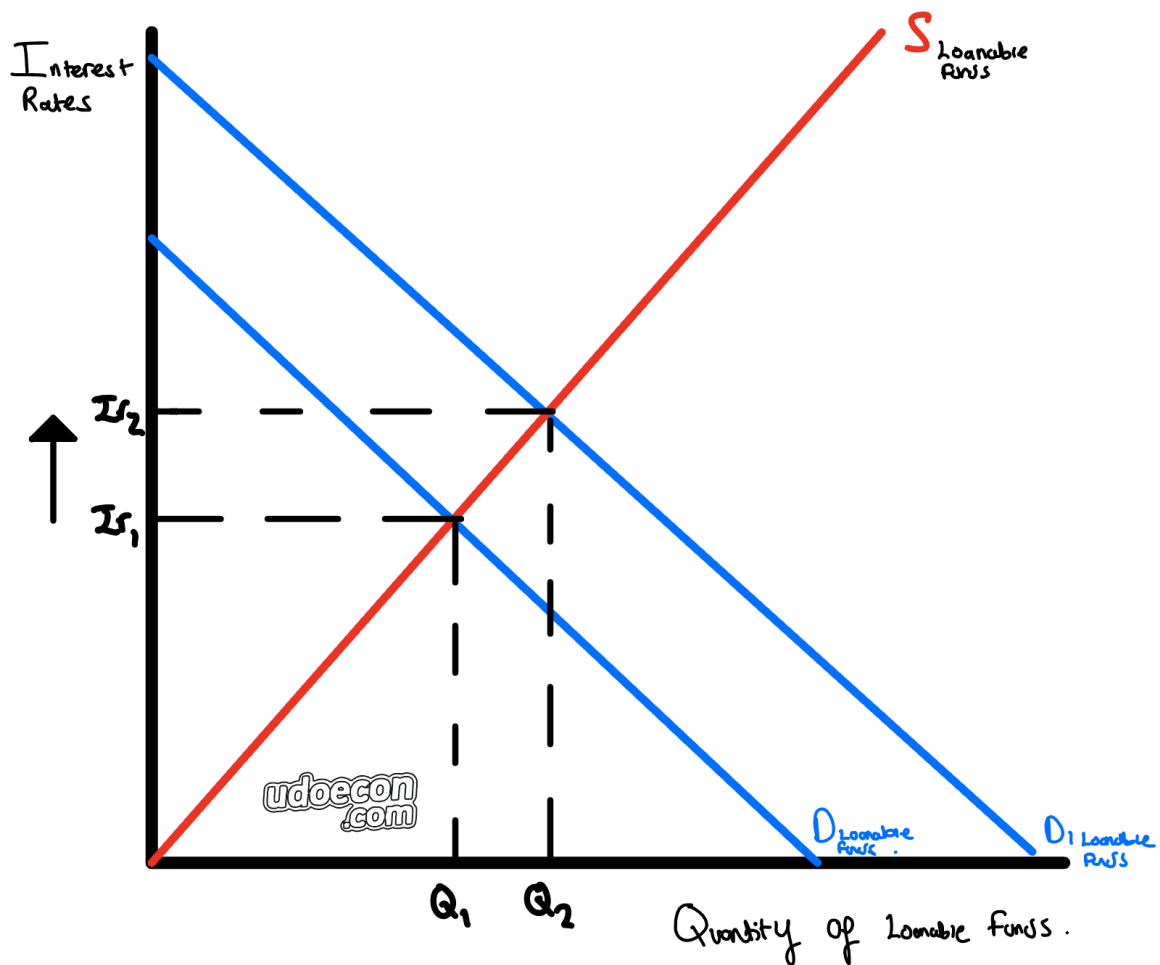
Living Standards

Government expenditure can increase living standards by providing healthcare, education, infrastructure and other public services.

Spending on services such as parks and libraries can directly improve quality of life, while better healthcare and education can improve living standards over the longer term.

Crowding Out

When government expenditure exceeds tax revenue, the government needs to borrow to finance its spending. This borrowing by the government increases the demand for loanable funds, thus shifting out demand from DLF to D1LF, this pulls up interest rates from IR1 to IR2 thus meaning the market interest rate has now increased, this means the cost of borrowing has increased for private firms thus decreasing incentive for private firms to invest thus limiting UK Economies long run economic growth.



Level of Taxation

Higher government expenditure may require higher taxation to finance the additional spending.

Higher taxes → lower household disposable income + potentially weaker incentives to work and invest.

Equality

Government expenditure can reduce income inequality and poverty through transfer payments and the provision of public services.

Spending on education and healthcare can also increase equality of opportunity, as access becomes less dependent on an individual's income.

However, the distribution of spending matters. If public expenditure is concentrated in particular regions, it may increase regional inequality and create differences in access to opportunities, such as the North–South divide in the UK.