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Dealing with the deficit – there is a better way

"People who think that fiscal expansion today is bad for future generations have got it exactly wrong. "The best course of action, both for today's workers and for their children, is to do whatever it takes to get this economy on the road to recovery." **Nobel prize-winning economist Paul Krugman, December 2008.**

In the June emergency budget, the Coalition claimed it would reduce total managed expenditure by 7.7% of Gross Domestic Product (GDP) to eradicate the deficit over the next 6 years. This amounts to cuts of £108 billion. But total managed expenditure also includes debt interest payments which over the next 6 years will rise to £36.6 billion. That means spending on services, benefits and jobs will be cut in real terms by £145 billion.

These, they say, will deal with our deficit.

A nation's deficit is caused by the combination of loss of revenue, lack of growth and the heavy costs of supporting those out of work.

Rapid, deep cuts risk a return to recession. Cuts will mean much less tax being paid by people and companies, and many more people drawing benefits. Cuts will not ease the deficit; they will make it worse.

The government has no strategy for growing jobs. Cuts without a growth plan are not a recovery plan – they are just cuts.

In dealing with the deficit, there is a better way.

Our economy in numbers

- The UK deficit is not high by historical or international standards; Germany, France and Japan have all got higher net debt than the UK.
- In April 2010, the IMF stated the UK has the lowest government debt as a proportion of GDP in the G7
- Debt is currently around 70% of GDP, between 1920 and 1960 government debt was never less than 100% of GDP
- UK debt is comparable to other countries' debt levels, and is held within the UK and structured over a longer period of time than other countries' debts
- The Treasury predicts its cuts will lead to at least 500,000 public sector jobs losses and between 600,000 and 700,000 jobs in the private sector being lost by the end of this parliament
- Unemployment is expected to surge above 10% in half of our regions by 2015
- Over two million are currently unemployed; new claimants are now at the highest level for fifteen years
- Over one million women are now unemployed
- Youth unemployment is also rising; over 200,000 18-24 year olds have now been out of work for over a year
- Public sector spending cuts could reduce private sector gross output by around £46 billion per annum by 2014/15
- The Coalition also plans to raise VAT to 20% from January 2011, cut benefit levels and impose a pay freeze on millions of public sector workers
- The cuts will make the poorest 10% of households worse off by £1,514 a year – or 21.7% of household income
- The richest 10% of households will lose just 3.6% of their annual household income
- With 65% of the overall public sector workforce female, women will be hit harder by job cuts and the two year pay freeze (2011-2013). 72% of the June Emergency Budget will be paid from women's income, according to the House of Commons Library
- For every four public sector jobs cuts, three more will follow

in the private sector

- While the Coalition cuts support to families, the banks are allowed to defer paying £19 billion in corporation taxes.
- Wealthy companies and individuals cost the country £25 billion a year in tax avoidance
- £4.7 billion can be raised by introducing a 50% tax rate on incomes over £100,000
- A tax on the banks, derivative trading and major hedge funds of just 5p for every £1000 transacted could generate £300 billion globally; in the UK tens of billions of pounds could be raised
- Public-private partnerships waste public money:
    - The internal market costs the NHS up to £20 billion a year
    - Private Finance Initiatives cost 8.3% of a hospital's budget, compared to 5.8% for conventionally-built hospitals
    - Privately-run GP centres cost seven times more per patient than standard NHS centres
- The Coalition's NHS reforms will cost £3 billion
- There is a powerful link between public spending and economic and social development
- Public spending is a catalyst for private sector growth, not an inhibitor. For every £1 billion spent on health, education and social work there is an increase in demand in the economy worth £1.854 billion
- Approximately 75% of the £1.854 billion generated by increased demand and reduced unemployment will finds its way back to the Treasury – about £1.391 billion
- The government has no strategy for growing jobs. Cuts without a growth plan are not a recovery plan – they are just cuts

In July 2010, the markets reported that UK deficit had narrowed, reducing government's borrowing requirements and prompting many to ask, why cut so hard, so deep and so quickly?

NECESSITY, OR IDEOLOGY?

> *"The British government's austerity package is based entirely on ideology, not on any economic rationale."*
> **Professor David Blanchflower, New Statesman, 20 September 2010**

The Coalition government argues that massive cuts – up to £145 billion in public spending – are necessary and unavoidable to reduce the economic deficit.

This is wrong. And it is dangerous.

Proof of the fragility of the economy is there for all to see. Over two million are currently unemployed, and new claimants are now at the highest level for 15 years. Wages are worth less as pay freezes and, as the rising cost of living takes hold, consumer spending shrinks. The banks continue to sit on money which businesses need to withstand the recession. Private sector specialists PriceWaterhouseCoopers confirms that one million jobs will be lost through the government's austerity drive.

Yet against this backdrop, the Coalition intends to impose the most severe programme of cuts in living memory, the speed and scale of which will lead to job losses estimated to be more than one million in the private and the public sectors combined.

How a government chooses to deal with a deficit says much about the society it hopes to nurture. Unite fears that the Coalition government's real objective is to scythe back the state – and that a hoped-for yet elusive combination of voluntary effort and private sector growth may help those displaced in the process.

But as we have learned from bitter experience in the 1980's, when government abandons its role as a stimulator of growth, social instability and deep, multi-generational poverty follow.

It is also of serious concern that the government is without a recovery plan. Cuts without growth are not an economic recovery plan – they are just cuts.

Those who argue against rapid cuts include economists Paul Krugman and Martin Wolf of the Financial Times. Both say that the time to tackle the deficit is when the economy is stronger, and that keeping people in work must be the priority for now.

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In July this year, the markets reported that the UK deficit had narrowed reducing government's borrowing requirements and putting the country on course to repay its debt over a faster period. So why cut so fast and so savagely?

The reality it that the deficit is being used as cover to unleash an ideological attack on public services – education, council and affordable housing, the NHS and welfare benefits – because the coalition government and its allies are fundamentally opposed to state provision.

With the economic rationale for cuts widely questioned, there must be a better way.

It will be progressive measures, combining income generation with a strategy for growth – not a one-note strategy of cuts alone – that will get us out of deficit and avoid recession.

Ahead of the Comprehensive Spending Review on October 20th, Unite says it is time for a Plan B.

The deficit – a symptom, not the cause

"Government debt is not like household debt: the government borrows from us through our savings and pensions, and when it has to pay us back it can simply refinance by borrowing again from the next generation of savers. Since investors – including our pension funds – always want to hold some government bonds, we always need some government debt....

"If the government were really listening to the bond markets they would be increasing government borrowing, not cutting."

Paul Segal, economist, University of Sussex and Harvard research fellow, the Guardian, 3 September 2010

Firstly, let's strip away some of the hysteria around the levels of UK debt. It is not particularly high for the UK by historical standards, or compared to other developed countries. Germany, France and Japan have all got higher net debt than the UK.

Secondly, it is not correct to compare the national economy to the household budget. Unlike the household budget, public spending is an economic multiplier so when the government spends money, it generates more money and wealth.

(If there must be a comparison with domestic budgets then when your income reduces it is not a rational decision to pay your mortgage off more quickly.)

And thirdly, Britain has just experienced its sharpest recession in the post-war period. The reason for this was not the fecklessness of ordinary people and their public services, or those who are forced to depend on benefits, but the catastrophic recklessness, leading to a near meltdown, of the world's global financial services.

The resulting slump caused a huge fall in tax income for the government, as unemployment rose and businesses folded. In addition, there were the vast sums of public money that the government was required to pump into the banking sector to save that industry from collapse.

As people lose their jobs or fear for their job security, they spend less, so income tax and VAT going to the Exchequer drops; as companies go out of business or make less profit, there is less corporation tax going to the government, and so on in a vicious cycle.

So, despite what some may argue, the deficit is not the cause of the recession and low economic growth. Instead, the deficit is a symptom of the recession.

Cuts aren't savings…they're cuts

In plans laid out so far by the Coalition, cuts to public services, benefits and pay and jobs will total £145 billion over the next five years.

The Treasury has predicted that these cuts will lead to at least 500,000 public sector jobs losses and between 600,000 and 700,000 jobs in the private sector being lost by the end of this parliament.

Prof David Blanchflower, a former member of the Bank of England's Monetary Policy Committee, has concluded that the private sector job losses will be greater than these estimates because the Treasury has based its calculations on totally unrealistic expectations as to how well the private sector will perform when there are big spending cuts and reduced access to lending. **In short, public spending is a catalyst for private sector growth, not an inhibitor.**

The government argues that cuts are needed because the public sector is crowding out the private sector, effectively stifling its ability to grow, but there is absolutely no evidence that this is the case.

In fact following the Thatcher government's attack on heavy industry in the 1980s, the biggest growth in jobs came from the public sector, which created 700,000 jobs in badly hit areas where the private sector had retreated.

Yet the Coalition's plans will

- raise VAT to 20% from January 2011
- cut benefit levels
- make over one million people unemployed in both the public and private sectors, and
- impose a two-year pay freeze on millions of public sector workers.

People will therefore have lower incomes and much less money to spend on goods and services. **Where, then, will the private sector growth come from?**

Many private companies will suffer a significant reduction in profits, with more going 'bust'. Unemployment will grow, with more people drawing benefits and fewer having money to spend, worsening the deficit.

Rapid, deep cuts risk a return to recession. They will mean much less tax being paid by people and companies, and many more people drawing benefits. They will not ease the deficit; they will make it worse.

Cuts didn't work for Ireland or Canada

Looking beyond our own shores we can see the proof that cutting your way to growth does not work for a nation's economy or social stability. So why is the UK repeating their mistakes?

Ireland: The Irish government has embarked on a series of "emergency budgets" that have dramatically cut public spending, including reducing wages and benefit levels and charging more for public services.

The result is that they are in their third year of an economic slump, and last year slipped back into recession. In August 2010, Irish unemployment climbed further, reaching 13.7%.

Canada: Some point to Canada as a template for the UK. What they don't say is that employment reached 10.4% and a domestic five year recession ensued. They also neglect to mention that Canada has a rich supply of resources and minerals to trade, and cut its public sector at a time when its major market, the US was booming.

As Jocelyne Bourgon, formerly Canada's senior civil servant in government and architect of the country's cost-cutting strategy, said: "*We had a bit of luck in that during the three years of the programme, there was not a global recession. That makes a difference, for sure.*"

Nearly a quarter of all Canadian public-sector employees – as many as 55,000 people – lost their jobs, equivalent to 1.5 million public sector workers in the UK.

The Canadian cuts also prompted a rapid rise in poverty and inequality. As the OECD commented in 2008: "*After 20 years of continuous decline, both inequality and poverty rates have increased rapidly in the past ten years, now reaching levels above the OECD average.*"

WHERE IS THE PLAN B?

> *"This unnecessary and dangerous budget will to push the economy back into recession…This is not scaremongering but a realistic possibility. The worry is that the government has no plan B"*
> **Prof David Blanchflower,**
> **June 2010 following the Coalition's Budget**

If it makes no economic sense to cut so deep and fast, it certainly makes no social sense either.

Already, cuts are hurting some of the most vulnerable in our communities. Ahead of the October CSR, Unite members report that jobs and services have been hit including:

- In the North West, Knowsley Borough Council, budget cuts mean that the Meals on Wheels facility for the elderly has been privatised.
- So too, has the service in Birmingham, where it is now unclear what provision there is for a hot evening meal for the users.
- Vital support for young people is under attack. In Birmingham, child services are facing £13 million worth of cuts; a staggering 1,500 jobs look set to disappear.
- The youth support organisation, Connexions has been hard hit by cuts already in Cheshire and Warrington where £1.7m has been slashed from the budget, leading to 75 redundancies so far. In Birmingham, 430 jobs are at risk in this particular service.
- In Southampton, ahead of the CSR cuts, £4 million is to be cut from the budget, with the majority coming from children's services.
- In Oldham, £45m in cuts to be made in the next two years have put 800 workers jobs at risk.
- In Birmingham and Sheffield, thousands of local authority workers are being told to accept poorer contracts or lose their jobs.

These are just a few examples of the cuts to date; far worse is to come as the CSR bites.

Economists Tim Horton and Howard Reed have estimated that the total impact of the cuts will mean that

- the poorest 10% of households will be worse off by £1,514 a year – this is 21.7% of people's household income
- but the richest 10% of households are losing just 3.6% of their annual household income
- and unemployment is expected to surge above 10% in half of our regions by 2015

Cutting costs jobs and growth

Spending cuts will make the deficit worse. While the Coalition promises that the private sector will be the motor of growth, Unite fears that it is still too fragile itself to promise growth.

In the private sector, in one 24-hour period this month, some 6,000 private sector workers lost their jobs as both Hewlett Packard and Lloyds TSB continued to cull their UK workforces.

Public sector cuts will hurt the private sector. According to PriceWaterhouseCoopers (in research published on 13 October 2010)

- almost half a million private sector jobs could be lost as a result of the upcoming public sector spending cuts and private sector gross output could be reduced by around £46 billion per annum by 2014/15 due to the impact on suppliers to the public sector
- that, when combined with OBR public sector job loss forecasts, nearly one million could face unemployment due to public sector cuts
- Scotland, Northern Ireland and Wales will be particularly hard hit by the cuts.

PwC also confirms that the Coalition's strategy will see public sector jobs out-sourced to the private sector, where terms and conditions are often poorer. Jon Sibson, partner and head of public sector at PwC, said:

"A sector likely to see growth opportunities from spending cuts is outsourcing, and not only in back office services. Government and public sector organisations will look to reduce their non-core and fixed cost operations by increasing the use of private and voluntary sector organisations for the delivery of front-line services."

When 4 jobs go, 3 more will follow

According to research for the Scottish government into the "multiplier effect", for every 1,000 public administration jobs cut we can expect there to be a total loss of 1,760 jobs in the economy.

This means that **for every four public sector jobs cut, three more will follow in the private sector.**

So where is the Coalition's plan for jobs growth?

Instead of a strategy for growth, alongside massive public sector cuts, the Coalition will

- Pull the plug on projects and programmes designed to stimulate regional growth and improve employment, (particularly youth employment) prospects, such as the Jobs for the Future Fund.
- Starve regions in desperate need of investment by scrapping the Regional Development Agencies, the boards charged with bringing inward investment to our heartlands.
- Revoke the £80m loan to Sheffield Forgemasters, the steel and engineering firm, denying it the opportunity to become a world leader in the production of components for nuclear power stations, one of only two in the world.

ARE WE ALL IN THIS TOGETHER?

The Coalition are fond of saying we are "all in this together". But the effect of their cuts will not be evenly felt.

Children will be hurt by the removal of child benefit for middle income families. Spiralling tuition fees will put higher education beyond the reach of the children of the low-waged, and burden students with levels of debt which they must carry throughout their working lives. The poor who depend on benefit support to afford private housing, necessary given the shortage of public housing in the UK, will be forced into crowded, substandard but cheaper accommodation when housing assistance is pulled.

Women and children first?

Women and families will be hit particularly hard by the government's cuts plans.

According to the Fawcett Society, the June budget will hit women especially hard, saying *"research by the House of Commons Library found that 72 per cent of the savings identified in the budget will come from women's pockets. This is because many of the benefits to be cut or frozen – including the Health in Pregnancy Grant, the Sure Start Maternity Grant and Child Benefit – are benefits that more women than men rely on."*

Added to this is the impact of the two year public sector pay freeze, which will hit women disproportionately as 65 per cent of public sector workers are women, and the Coalition's plans to end the universal entitlement of women to child benefit.

Unite backs the Fawcett Society's challenge to the government in the High Court arguing that its plans did not, as is required by law, consider the impact of the measures in the budget on equality.

Women's wages are also vital in helping to fight family poverty. However, the drive toward fragmentation and privatisation endangers national agreements on terms and conditions that support equity.

According to Professor John Hills of the National Equality Panel, the national minimum wage helps reduce income inequality but it must be raised or this dividend will be lost. However, the government indicates that it 'is minded' to abolish the Fair Deal requirements on local authority contracts. If so, it will be women cleaners, cooks and carers who will find their wages driven down lower and it will be their children who will continue to carry the burden of disadvantage.

The latest ONS figures (October 2010) confirm that it is women, and younger workers who are being hit hardest too by the rapid growth in job losses. Unemployment among women continues to rise and now stands at over a million, and will rise still further as jobs go in the public sector.

Youth unemployment levels are also very concerning. In August, youth unemployment increased by 14,000; over 200,000 18-24 year olds have now been out of work for over a year which, as we saw in the 80's, has a long term effect on future chances.

THERE IS A BETTER WAY

> *"Death from an infected toenail was par for the course before the discovery of antibiotics. Medical advances have now made it eminently avoidable. Keynesian fiscal policy is a great advance over the 19th century economics.....We should use it".*
>
> **Paul Segal, University of Sussex, the Guardian, 3 September, 2010**

Tax justice, end waste and stop privatisation to make our economy stronger

Tax justice, clamping down on tax avoidance by the rich and business, would raise money for the government to invest in deficit reduction.

According to Professor John Hills, a tax on big financial transactions by banks could raise £3 billion a year, and £4.7 billion can be raised by introducing a 50% tax rate on incomes over £100,000.

The campaign for a transactional tax on the banks, derivative trading and the major hedge funds of just 5p for every £1000 transacted could generate £300 billion globally and in the UK tens of billions of pounds, all money that can be used to support our services and build the economy.

And while an unspoken aim of the government may be to shrink the state by transferring its functions to the private sector, time and time again this has been shown to be a false economy. The private sector is inefficient and expensive when asked to provide public services.

In the NHS alone, according to Prof Allyson Pollock, professor of international public health policy at the University of Edinburgh, the internal market in the NHS may cost up to £20 billion a year. This is wasted money that should be spent on patient care and public services.

Also

- Private Finance Initiatives (PFIs) currently cost 8.3% of a hospital's budget, compared to 5.8% for conventionally-built hospitals. By the time Neath Port Talbot Hospital in Wales has repaid its loan repayment over 30 years, the cost including maintenance will exceed £445 million. The building is only worth £66 million.
- Privately-run GP centres cost seven times more per patient than standard NHS centres.
- And health secretary Andrew Lansley's reforms programme is set to cost a staggering £3 billion, a huge and costly walk into the unknown which could see the NHS fail to function and place it at the mercy of private health providers stalking it from the sidelines.

Public spending is an economic multiplier; when the government spends money, it generates more money and wealth.

Government therefore recoups its original spending money – and more in return.

Using Office of National Statistics (ONS) figures, we can see how spending public money leads to economic growth and reduces the deficit.

The ONS has calculated that for every £1 billion spent on health, education and social work there is an increase in demand in the economy worth £1.854 billion.

This is because when the government spends money on health, education and social work this involves buying more medicines, surgical instruments, beds and other health equipment, uniforms, printed textbooks, computers and so on. And these products are all made in different sectors of private industry so spreading the gain between the sectors.

These employed people then pay their income tax and spend more. The private companies receive more orders for equipment make bigger profits and pay more in corporation tax.

The combined impact of this increase in tax revenue and the reduction in benefit payments to those lifted out of unemployment means that approximately 75% of the £1.854 billion increased demand in the economy finds its way back to the Treasury – about £1.391 billion.

So, for every £1 billion the government spends on health, education and social work it not only gets this money back, but an extra £391 million which can be used to rebuild the economy.

It is perfectly reasonable then to conclude that as a nation we can create jobs in all sectors of our economy, continue improving public services, support the private sector and reduce the deficit through public investment by the government.

The Public Services International Research Unit at the University of Greenwich confirms the case for using the public sector to drive growth. In its report, 'Why we need public spending', it concludes that:

- There is a powerful link between public spending and economic and social development.
- Spending is now at historically high levels of 40% of gross domestic product (GDP) in OECD countries, and rising in developing countries.
- Public spending is a key factor in economic growth and development. It is essential for financing, and it provides the health and education services necessary for modern economies more efficiently and effectively than the market could provide.
- Public spending has been used worldwide to provide an economic stimulus to counter the recession, and to rescue the banks through public ownership.
- The economic crisis was not caused by government deficits, but it is being managed through public spending.
- Public healthcare, housing and other services protect people from illness and develop cities without slums. Three-quarters of the global effort to counter climate change will come from public finance.
- Overwhelmingly, the increase in government deficit and debt has been due to the crisis, not to spending profligacy by governments. Attacks on these deficits risk pushing economies back into recession.

- Fiscal limits, such as the EU rules against deficits over 3% of GDP, are arbitrary figures. Markets speculate against countries' borrowing because they are relatively small; there is no link with actual deficit or debt levels.
- Privatisation and public–private partnerships (PPPs) are illusory ways of raising money, which conceal public borrowing to evade fiscal limits set by the International Monetary Fund (IMF) or the European Union. They are more expensive than direct government borrowing.
- The better alternative is to develop stronger and fairer taxation systems and to continue to grow public spending to meet the challenges of the future, including climate change.

(The report is available at http://www.psiru.org/reports/2010-10-QPS-pubspend.pdf)

Cutting in whose interests?

Neither party in the Coalition stood on an agenda of the profound cuts about to be unleashed on the country. They do not have a mandate to dismantle the system of social provision in the UK built and supported by generations of taxpayers.

Nor are the speed and depth of their cuts supported by economic experts.

Our government has a duty to serve the interests of all in society.

The evisceration of our public services is in no-one's interest.

It will be progressive measures, combining income generation with a strategy for growth – not a one-note strategy of cuts alone – that will get us out of deficit and avoid recession.

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