LEAP | Left Economics Advisory Panel

The Osborne Ready Reckoner

This dossier tests some of the claims made by George Osborne in his Emergency Budget statement in June 2010.

It highlights the flaws in that statement, the assertions underpinning his macroeconomic policy, as well as putting economic arguments against some individual policies.

The dossier also highlights some of u-turns the government has made since the statement – most noticeably their decision to scrap universal entitlement to child benefit.

Fundamentally though, the Osborne economic strategy is simply a Thatcherite ideology that wishes to 'roll back the state'. Today the small government idea is the 'Big Society'. This is not about strengthening society, but burdening it.

The same Party that tells us the Big Society will take on the role of the state in key areas, also tells us we are living in a 'broken society'. The effect of the cuts planned on this scale would be, if implemented, to leave Britain with a legacy of a 'broken government' to match the Tories' broken society.

Government revenues have fallen due to the recession – there are more people out of work claiming benefit and paying taxes, because there are fewer jobs. Today there are 2.5 million people unemployed and less than 500,000 vacancies.

The Tories have no strategy for job creation or economic growth – only for cutting spending down to the level of revenues from an underperforming economy. The only outcome of their pessimistic strategy is misery for millions of families.

This dossier puts the economic arguments against the Osborne strategy.

John McDonnell MP
LEAP Chair

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In bold: what Osborne said, below: what we say

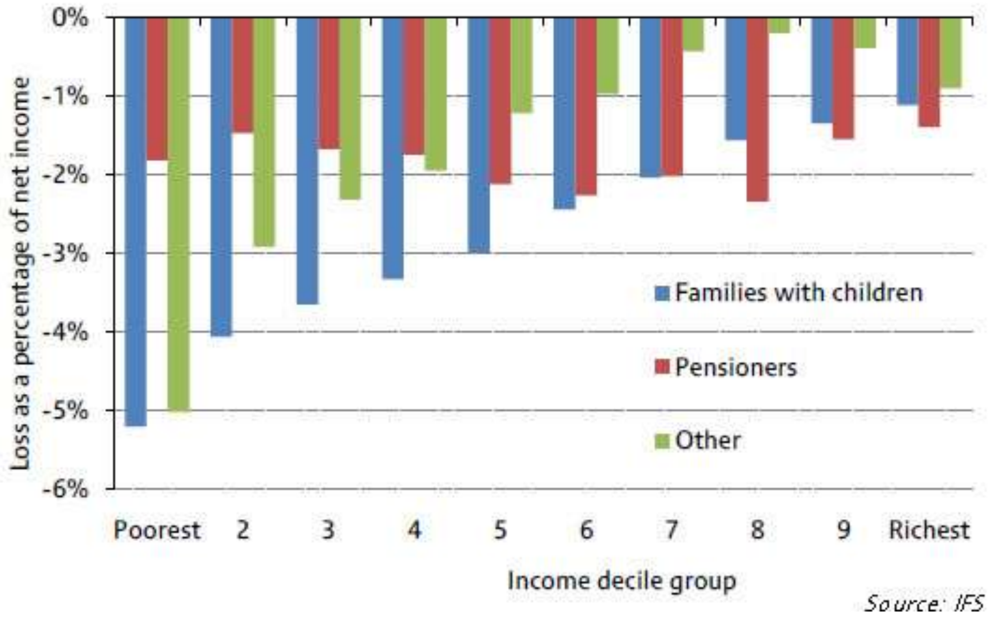
1. "This emergency budget deals decisively with <u>our country's record debts</u>"

Research published by the PCS trade union[1] shows that between 1918 and 1961 the UK national debt was over 100% as a proportion of GDP. Today the national debt is, according to the ONS, 56.3%.

This UK debt is lower as a proportion of GDP than that of other major economies like the US, Japan, France and Germany.

2. "the richest pay more than the poorest. Not just in terms of cash but as a proportion of income as well", "the people at the bottom of the income scale will pay proportionally less than the people at the top. It is a progressive Budget"

Figure 2: The effect of tax and benefit reforms announced in the June 2010 Budget to be introduced by April 2014 by income decile group and household type



Analysis by the Institute for Fiscal Studies (see Figure 2 above) clearly shows that the Budget was in fact "clearly regressive". The IFS said, "once all of the benefit cuts are considered, the tax and benefit changes announced in the emergency Budget are clearly regressive" as "they hit the poorest households more than those in the upper-middle of the income distribution in cash, let alone percentage, terms".

[1] See 'There is an Alternative: the case against cuts in public spending' published by PCS in Sep 10 http://www.pcs.org.uk/download.cfm?docid=23E6E0DF-0C3D-4AB1-A78C815E8CBC4771

3. "This is the unavoidable Budget"

This is a nonsense. It was clearly about political choices, just a few examples:

- Raising VAT was highly regressive, as it disproportionately hits the poorest income earners the hardest
- There was £11 billion in welfare cuts, but over £24 billion in corporate tax breaks
- The promised privatisations of assets such as the Royal Mail, the Tote and the student loan book will deprive the exchequer of annual revenue to close the deficit

4. "An economy where the state does not take almost half our national income, crowding out private endeavour"

Cutting the public sector won't 'make room' for the private sector, but will sap demand and weaken the private sector too. The Office for Budget Responsibility recognised this when a leaked document[2] showed cuts of 600,000 public sector jobs would have a knock-on effect, costing 700,000 jobs in the private sector.

The 'crowding out' theory asserts that the public sector crowds out productive private businesses, and must get smaller – fast. As the state shrinks, manufacturers will grow. Commenting on the theory, Professor Roger Middleton, economic historian at the University of Bristol, says "It was wrong conceptually, and it was wrong empirically".

Following work by academics Roger Bacon and Walter Eltis in the 1970s, 'crowding out' was picked up Denis Healey and then by Margaret Thatcher and Keith Joseph. Crowding out, and the other fashion for stamping on inflation, informed Thatcher's early budgets and led to a painful economic slump. According to Manchester University's Centre for Research on Socio-Cultural Change, it also led to one in five of all manufacturing jobs being lost within 18 months in the early 80s. When Britain did finally get out of its slump, it was arguably thanks to a devalued pound and a financial boom. It wasn't due to the crowding-out doctrine[3].

5. "Growth in the UK economy for the coming five years is estimated to be: 1.2% this year and 2.3% next year"

Since the Budget, major forecasters have downgraded UK growth prospects for 2011. This happened soon after the Budget was delivered:

- On 8 July 2010, the IMF downgraded its UK growth forecast to 2.1% for 2011

[2] See 'Budget will cost 1.3m jobs – Treasury'. The Guardian, 29/06/10: http://www.guardian.co.uk/uk/2010/jun/29/budget-job-losses-unemployment-austerity
[3] See Aditya Chakrabortty 'Why George Osborne sounds like Margaret Thatcher in the 1970s'. The Guardian, 05/10/10

- In August, the Bank of England downgraded its growth forecast for 2011 from 3.4% to 2.5%
- In September, the credit rating agency Moody's downgraded UK growth to 2.0% for 2011
- In October, the IMF's World Economic Outlook report estimated UK growth would be 2.0% for 2011

New estimates from the Office for Budget Responsibility won't be published until 29 November.

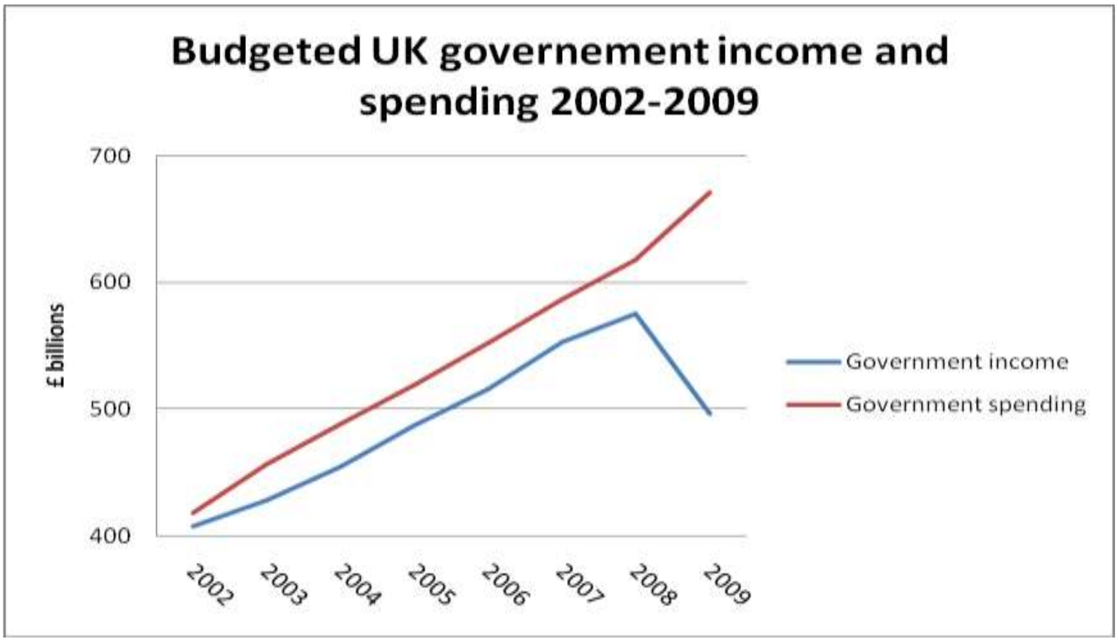
6. "Consumer price inflation is expected to reach 2.7% by the end of the year before returning to target in the medium term"

Inflation figures published by the ONS showed CPI at 3.1% and RPI at 4.6%. CPI was unchanged on the previous month. The VAT increase, from 17.5% to 20%, takes place on 4 January 2011 and is predicted to have an inflationary impact.

However, it should be made clear that there is no risk from rising inflation in the foreseeable future.

7. "The country has overspent; it has not been under-taxed"

Since 2002, government spending went up at almost exactly the same rate as government income, until the collapse of 2008 (as the graph below shows):



It was the collapse in revenues, not a rise in spending that caused the government deficit to increase. Spending increased marginally post-2008 because welfare spending increased due to rising unemployment, as a result of the recession.

However there are two reasons for asserting that the UK has been under-taxed. Firstly there is the UK tax gap of £120 billion in evaded (£70 billion), avoided (£25 billion) and uncollected (£26 billion) tax.

Secondly, the main income tax and corporation tax rates were cut by New Labour. Corporation tax was cut from 33% in 1997 to 28% by the time New Labour left office – this saved business around £50 billion by 2010, according to LEAP estimates[4].

8. "the government can also dispose of assets which should rightly be in private ownership"

The word 'assets' should be a clue here. If you are trying to reduce a budget deficit why would sell assets – i.e. things that generate revenue?

The assets identified by Osborne were: High Speed 1 rail, NATS, the student loan book, the Tote and Royal Mail.

High Speed 1 has not yet been built so we cannot judge its performance as a revenue generator, but:

- NATS reported profits of £78.3 million in 2010
- Royal Mail reported profits of £321 million in 2009
- The Tote reported profits of £156 milion in 2009

In addition the Student Loan Company received £900m in 2008/09 in student loan repayments. Why would any prudent Chancellor lose these assets, generating sizeable annual income for a one-off bonanza?

9. "we need to do something about the spiralling costs of public sector pensions"

As the Hutton report showed, public sector pension costs are not spiralling. The cost of public sector pensions today is 1.9% of GDP in 2010-11, but by 2060 that will have fallen to 1.4%.

It is estimated that the change to pension calculations from RPI to CPI will save the Exchequer £150 billion over the next 40 years. The 2005 agreement on public sector pensions between the government and trade unions also cut long-term costs.

[4] See http://leap-lrc.blogspot.com/2010/02/to-big-business-50bn-with-love-new.html

10. "Total welfare spending has increased from £132 billion ten years ago to £192 billion today. That represents a real terms increase of a staggering 45%"

In September 2000, claimant count unemployment was 1.035 million, for September 2010 claimant count unemployment was 1.47 million. So the staggering real terms increase of 45% is not that "staggering" when one considers 42% more people were claiming unemployment benefit.

Welfare spending increased due to rising unemployment, as a result of the recession.

In real terms the value of many benefits, including Jobseeker's Allowance, fell under New Labour. If JSA had kept pace with earnings since 1997 it would have been worth over £75 per week by 2009, instead it was just £64 per week.

11. "The consumer price index not only reflects everyday prices better, it is of course now the inflation measure targeted by the Bank of England"

It is disingenuous the say that the CPI is the Bank of England's measure. The CPI was introduced to make it easier to compare inflation across EU Member States. The measure excludes housing costs as there are huge differences across the continent in housing markets and levels of home ownership. It was Gordon Brown who introduced it as the measure the Bank of England should use in 2003.

CPI excludes housing costs which, since we don't live a cave-dwelling society, means it does not reflect better the full cost of living, and 30% of pensioners still have mortgage payments outstanding. RPI also includes Council Tax, rents and household insurance.

Using CPI rather than RPI will mean benefit rates will fall further behind living standards. CPI is currently 1.5 percentage points below RPI, and has averaged 0.75 below over the last 10 years.

12. "I know many working people feel that their child benefit is the one thing they get without asking from the state. So instead, to control costs, we have decided to freeze child benefit for the next 3 years. This is a tough decision, but I believe its strikes the right balance between <u>keeping intact this popular universal benefit</u> while ensuring that everyone, across the income scale, makes a contribution"

Just three-and-a-half months later, George Osborne said “We've got to be tough but fair. That's why we will withdraw child benefit from households with a higher rate taxpayer.”

The unfairness in the current proposals unveiled on 5 October are well publicised. The IFS said: “to give an extreme example, the Government's proposed reform implies that a one-earner couple with an income of £45,000 would lose all their child benefit, but a much better-off couple where each has an income of £40,000 would keep all their child benefit.”

Of course, freezing child benefit for three years, as announced in the Budget will means a real terms cut of over 10% by the third year for everyone.

13. “Today there are some families receiving £104,000 in housing benefits”

Housing benefit claims are in most cases directly paid to landlords, and even if not are used by people to pay their rent.

The real problem of course is that the Thatcher government abolished Fair Rent Tribunals, and attacked council housing. So now if people need housing, there is no council housing available and the state ends up subsidising the inflated demands of private landlords.

14. “It is my deeply held belief that a genuine and long-lasting economic recovery must have its foundations in the private sector. That is where the jobs will come from.”

The Office for Budget Responsibility stated in June that although the government's cuts would cost 600,000 public sector jobs, with a knock-on loss of 700,000 in the private sector, the private sector would also create 1.6 million jobs over the same four year period (a net gain of 300,000 jobs).

However, a report published by Pricewaterhousecoopers on 13 October shows in fact that the private sector will only create 1 million jobs over the four years, so that becomes a net loss of 0.3m jobs. It undermines Osborne's claim that cutting the public sector can be compensated by private sector growth.

15. “Corporation tax rates are compared around the world, and low rates act as adverts for the countries that intoduce them . . . Four annual reductions in the rate of corporation tax that will take it down to just 24%”

Cutting corporation tax does not increase revenues. Cuts in corporation tax encourage ‘brass plate’ investment, where companies registered in a country without actually moving staff there.

As experience in the Republic of Ireland has convincingly proved, when the state recedes the private sector does not rush in to fill the void. It flees in the face of falling demand.

New Labour cuts to corporation tax cost the Exchequer £50 billion in revenues over their period in office.

16. “On 4th January next year, the main rate of VAT will rise from 17.5 to 20%”

This VAT increase, as well as being regressive, will also undermine the private sector recovery, which is already weak as recent surveys have suggested.

The British Chambers of Commerce (BCC) and the British Retail Consortium both warned that growth in the service sector had been "slow" and was showing no signs of picking up before the VAT rise in January next year.

Shoppers and consumers had been expected to cash in on the final few months before the introduction of 20 per cent VAT on luxury goods.

BCC chief economist David Kern said: "The dismal performance of the service sector is particularly disturbing since it occurs even before VAT is due to rise to 20 per cent."