LEAP | Left Economics Advisory Panel

Breaking the Cuts Consensus

Red Papers

March 2010

- **John Grieve Smith** on the misplaced obsession with the budget deficit
- **Gordon Nardell** calls for an international, government-led mechanism for public sector debt
- **Andrew Fisher** highlights the alternatives to cuts, and why the consensus is wrong
- **Gerry Gold** argues there are no solutions from neoliberals or Keynesians
- **Graham Turner** argues the UK needs a manufacturing strategy to escape the crisis
- **Jerry Jones** argues that weak labour laws rather than migrant labour damages employment and the economy
- **John McDonnell MP**

Edited by Andrew Fisher

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The Deficit Election

These *Red Papers*, published just prior to the March 2010 Budget Statement are probably the most overtly political set of Red Papers that LEAP has published. Following the 2010 Budget, the announcement of the General Election will only be days away.

The economy will dominate the General Election campaign, with Labour portraying itself as the party most geared to ensuring the recovering, the Tories promising to restore UK credibility with the global markets – and the Liberal Democrats fluctuating between the two, in the hope of having some relevance in a possible hung Parliament.

Despite all this posturing though, the reality is that there is very little difference between the parties. All are going into the election advocating major cuts to public services to reduce the deficit, and all are sharply critical of any group of workers who dare suggest that they should not be made redundant or that their pay or pensions should not be cut.

The reality remains that all the major political parties are loyally committed to neoliberal economic dogma, despite the global economic collapse it has wrought. Therefore whatever the outcome of the election, the economic crisis will not be resolved.

We need an alternative economic agenda that puts people first. These *Red Papers* highlight the errors of the current orthodoxy and articulate some alternatives.

John Grieve Smith argues that the pre-election cuts consensus is driven by misplaced obsession with the budget deficit, and that such cuts would be damage the economy. The 'misplaced obsession' could be countered by an international, government-led mechanism for pricing and trading public sector debt, argues **Gordon Nardell**.

An alternative to the cuts consensus, based on tax justice and public ownership, is argued for by **Andrew Fisher**, while **Gerry Gold** explains why neither the solutions offered by neoliberals nor Keynesians can solve the global crisis.

Graham Turner argues that the crisis in the UK is exacerbated by the decline of manufacturing, on contrast to other countries that have had a clear manufacturing strategy, while **Jerry Jones** tackles another election issue – migration – arguing that trade union rights are the solution to exploitation and under-cutting.

As **John McDonnell MP** concludes, no party is adequately addressing these issues because none want a more democratic system

Andrew Fisher
Editor, *LEAP Red Papers*
March 2010

Competitive Deflation

John Grieve Smith

- There is a misplaced obsession with budget deficits, fuelled by finance sector panic more than reality
- Budgets cuts slashing the public sector would be economically damaging
- Public sector productivity cannot be measured in the same way as private sector productivity

There is a serious risk that Labour and the Tories could get into a pre-election competition to show who is going to be toughest in cutting public expenditure to tackle the budget deficit. There are three serious dangers in this.

The first is that deflationary cuts might be imposed before the economy is fully recovered from the recession. Here Labour has clearly taken the correct position. Alistair Darling has said he would not make any such cuts before the economy had recovered; whilst the Tories are calling for immediate cuts in public expenditure.

The second is that even when the economy has fully recovered, cuts in expenditure to match the increase in interest payments on the public debt could have an unwanted deflationary effect. This is because the extra interest is for the most part going to foreign or British financial institutions or investment funds and is not increasing demand for goods and services; but any cuts in public expenditure would involve a direct reduction in demand.

The third danger is that the current emphasis on cutting expenditure, rather than raising taxes, is posing a serious threat to the future of many public services – many of which are already under financial pressure. The most recent official figures for public expenditure over the next few years (in the December Pre-Budget Report) are already unrealistically low, and imply cuts rather than improvements in public services. General ignorance of this (except among those actually managing such services) is largely due to the Treasury's continual misleading reference to "real increases" in expenditure. In economic phraseology this means any increase greater than the rate of inflation. For example, on the Treasury assumption that across the economy as a whole, pay goes up by 4 per cent, productivity by 2 per cent and average prices by 2 per cent, any increase in expenditure of more than 2 per cent is called a "real increase".

"most public sector expenditure is labour intensive with little, if any, scope for increasing productivity . . . more pupils per teacher, or patients per nurse, generally means a decline in standards, rather than increase in productivity"

But most public sector expenditure is labour intensive with little, if any, scope for increasing productivity. This applies particularly, for example, to the armed forces; and in education and the health services, more pupils per teacher, or patients per nurse, generally means a decline in standards, rather than increase in productivity. If teachers and nurses get the average pay rise of 4 per cent a year, an increase in expenditure of 4 per cent a year in money terms, is needed to maintain the same manpower. It is highly misleading, to those not familiar with economic jargon, for the Treasury to use the phrase "real increase" of 2 per cent for a money increase of 4 per cent increase in expenditure, implying that such an increase would involve enough money to improve or expand such a service..

The key example of this is the reference in the December Pre-Budget Report to a real increase in public sector current expenditure of 0.8 per cent a year from 2011-12 to 2014-15. This is equivalent to 2.8 per cent a year in money terms, insufficient in most areas to maintain the existing labour force – without substantial cuts in relative public sector pay. Rather than implying improvements in public services, it would mean that it would be difficult to maintain present standards, and widespread cuts would be needed, without any additional economy measures.

The government should be considering tax increases as an alternative to expenditure cuts. The problem at election time, however, is that unspecified expenditure cuts may be more acceptable to voters than unspecified tax increases. Tax increases should, however, be targeted on higher income groups to combat the increasing inequality of incomes, and Labour could propose such increases as an alternative to Tory cuts. One advantage of this alternative in macroeconomic terms is that tax increases on the well-to-do could involve a much lower reduction in the demand for goods and services than cuts in public expenditure.

The present preoccupation of the press and politicians with the budget deficit is justified more by the political unpopularity of possible measures to rectify it, rather than any fundamental inability to do so. The recent concern about financial markets' confidence in gilts does not reflect any real risks to bondholders. No serious observer should think that a major industrial country, like the UK, would default on the interest payments or redemption of its government bonds.

The first essential is to ensure that the effects of forthcoming budgets are tuned to the macroeconomic situation and a return to full employment. It is very much to Labour's credit that the government has taken the lead in successful international budgetary action to get out of the recession.

Price and prejudice: Why public sector debt needs a public sector trading mechanism

Gordon Nardell

- The level of risk in budget defaults are being overemphasised by markets
- Current levels of public sector debt are more sustainable than the private sector debt that created the crisis
- A new international government-led mechanism for pricing and trading public sector debt is needed

The parties' pre-election battle has descended into a virility contest on spending cuts, driven by a consensus that public sector borrowing is "out of control" and needs to be urgently reduced. This week, the Tories opportunistically seized upon the European Commission's assessment that "a credible time frame for restoring public finances to a sustainable position requires additional fiscal tightening measures beyond those currently planned" as evidence that New Labour's cuts fail to bite deeply enough quickly enough. But exactly what is it that's "unsustainable" about current levels of public debt?

Put into a global perspective, UK government borrowing, at just under 68.7% of GDP on recent IMF figures[1], is comparable with other developed nations – 85% for the USA, for example – and much lower than several others: 115% for Italy and 218% for Japan. By these lights even beleaguered Greece, at 125%[2], isn't in quite the irredeemable state the lurid headlines might suggest. The relative positions remain fairly constant even as you track the IMF's projected overall deterioration to 2014. The UK at 98% will be slightly more heavily indebted than France at 96%, but still in a considerably more comfortable position than the USA at 108% and far less burdened than Italy at 128% and Japan at a staggering 245%. In fact the trend predicted by the IMF may well prove to be excessively pessimistic. The UK's budget deficit has recently been lower than forecast, leading to net borrowing at the end of February £2.4 Billion less than expected

But more telling still is the comparison between current UK government debt and the towering levels of private sector borrowing accumulated in the years before the credit crunch. The figures are well rehearsed in the pages of previous *Red Papers*. Private debt mushroomed from 196.8% of GDP in 1996 to 250.1% in 2003 and continued to rise steadily into 2008. That included corporate and producer borrowing, and needless to say a portion of that effectively represented the working capital reasonably required to fund the economic activity reflected in GDP. But it also included less benign elements. Much consisted of speculative financial instruments – fictitious capital – with no productive value whatsoever in the real economy. And buried in the total was an increasing proportion of consumer borrowing. In the year to June 2007, borrowing on mortgages, personal loans and credit cards, at £1.35 Trillion, exceeded GDP (about £1.34 Trillion) for the first time. The following year, borrowing rose to £1.44 trillion (up 7.3%) outstripping the growth in GDP to £1.41 trillion (up 5.1%). And so it continued, with consumer debt rising a further 9.1% in the following year.

LEAP was not alone in predicting that a bubble of this size was sooner or later bound to burst, with catastrophic consequences. But what the markets saw was the bottom line of economic growth, happily ignoring the crippling levels of debt on which it was based. Stock

[1] IMF
[2] The IMF figure. On the measure quoted by *The Economist* in an article in February, the figure is lower at 112.6%. See http://www.economist.com/world/europe/displaystory.cfm?story_id=15452594

markets rose while bond markets gave national finances the blessing of low yields. Now the inevitable crisis has happened, and the same markets cast a jaundiced eye on debt. With the cost of the banking bailout hitting the public purse while tax revenues plummet, the government's annual budget deficit inexorably rises – this year it's likely to be reported as 12.6% of GDP against the European Commission target of 3% – and overall state debt increases with it.

An obvious response to that state of affairs is: "so what?" And by any objective standard that response is a perfectly reasonable one. Government borrowing, even at levels high by recent historic standards, is still an order of magnitude less than the pre-crisis levels of private indebtedness. More importantly, the underlying security of government finance is a world apart from the pre- credit crunch debt mountain. The run-up to the Northern Rock drama in late 2007 was characterised by the accumulation of sub-prime lending, high loan-to-value mortgages, and the phenomenon of the lowest income individuals suffering the highest debt-to-income ratios. Delinquent credit in the US and UK is still at record levels. But the reality is that neither the UK nor any other European economy is anywhere near a serious risk of default in its sovereign debt. There is simply no principled reason why these economies cannot carry their current and projected levels of indebtedness, and no reason why – in itself – doing so might be economically harmful. In fact the reverse is true: at a time of falling tax revenues have fallen, state expenditure, funded by borrowing, is a critical motor force for promoting and sustaining recovery.

That leaves the answer to the "so what?" question a purely pragmatic one: the market view of debt. Steep yield curves have characterised the post- credit crunch bond markets, as dealers and ratings agencies mark down the security of sovereign debt. In simple terms, current "high" levels of debt imply high borrowing costs, making attempts to borrow to maintain or increase public expenditure at least partially self-defeating.

"private markets' attitude to public sector borrowing is not an objectively justified fear or concern about the quality of the debt, but little more than an irrational prejudice or phobia"

In the absence of any defensible reason for fearing these levels of debt – and bearing in mind the markets' failure to react to the dangers inherent in the private credit bubble – there is only one conclusion: private markets' attitude to public sector borrowing is not an objectively justified fear or concern about the quality of the debt, but little more than an irrational prejudice or phobia. It's simply another facet of the familiar "public bad, private good" mantra that characterised so much "mainstream" economics of the 80s and 90s. Interestingly, non-market commentators have taken a much more rounded view of debt. In a report issued in May 2009, the IMF focused its concerns not on public sector debt but on persistent volumes of household and consumer borrowing, which it warned made the pace of recovery, if any, "uncertain".

Hence the "so what?" becomes – "so what do we do?" The crucial task for governments is to correct the illogic of relying essentially on private markets to operate the issue and trading of public debt. Following the Second World War – also a time of high government borrowing – policymakers recognised that the challenge of reconstruction could only be met by the creation of intergovernmental machinery. And so emerged the IMF and World Bank. The IMF in particular was hijacked in its later life by Washington consensus thinking. But the concept of a government-driven system, stepping in where private capital cannot satisfy the needs of development, remains a sound one.

Government debt could still be issued and traded commercially, but governments would have far more control over the terms of lending including the crucial question of yields. A further benefit of such a system would be its potential to prevent speculative runs on an individual State's sovereign debt – much as Greece has faced in recent weeks, with knock-on effects on the entire Eurozone and beyond. It would be possible, for example, to insist that most debt be traded in the form of consolidated parcels representing loans to several countries, rather than a single nation's debt.

Beyond this month's budget, this is the sort of solution Europe's left governments – including those in the UK and Greece – should be pioneering , not placating the markets with cuts and austerity programmes.

Tackling the Cuts Consensus

Andrew Fisher

- The party political consensus around cuts is obscuring the popular alternatives available
- Budgets cuts slashing the public sector would be economically damaging
- Rising inequality, inherent in neoliberal economics, has caused the current crisis and therefore can only exacerbate it

In the debates around the Budget and in the run-up to the General Election, there is a clear consensus among the main political parties. The solution to the national deficit is to cut public services.

We have a national deficit because the banking sector collapsed sparking a recession. Bailing out the banks cost billions, and the recession hit tax revenues and increased unemployment. Public services did not cause this crisis, and we should not have to pay for the crisis through cuts in our services.

What runs through all the attacks on the terms and conditions of public sector workers is a brutal logic that wages and pensions should be forced down to the lowest level. The benchmark for this is the private sector where wages are compared to non-unionised workers, as in the BA dispute.

"There are alternatives, but they won't be found at the ballot box. This is because they require a redistribution of wealth and power in the other direction: from rich to poor"

As Graham Turner has pointed out, this global race to the bottom is central to the economic collapse we have seen around the world. Squeezed consumers are defaulting on mortgages and personal debts, and are less able to spend in the economy.

This is not a theory, but a fact: the share of Britain's national income going to wages has declined from 65% in the 1970s to 53% today. The same phenomenon has been witnessed around the world. Neoliberal economic practice is devouring itself, and with it ruining millions of lives.

There are alternatives, but they won't be found at the ballot box. This is because they require a redistribution of wealth and power in the other direction: from rich to poor.

Tax Justice

Research by the Tax Justice Network and PCS estimates that £70 billion is lost every year through tax evasion and a further £25 billion is lost through avoidance, by big business and wealthy individuals. Much of this could be recovered if more tax inspectors were hired and the legal loopholes were closed.

But the Government is cutting the number of tax staff every year. Last year this meant that another £27.7bn of tax went uncollected by HM Revenue & Customs.

By just collecting the tax that is rightfully ours, including from the wealthy and big business, we could avoid public service cuts . . .

The organisers of the 'Robin Hood Tax' campaign estimate that introducing just a 0.05% tax on financial speculation could raise $400bn globally.

Making use of Public Ownership

We own several banks. They were bailed out with taxpayers money, having done massive damage to our economy, so it seems reasonable that they should be run in the public interest; i.e. use their profits to invest in public services. If other services collapse and need to be bailed out, let's run them to make a profit for the people who bailed them out: taxpayers.

Thirty years ago, gas, electricity, water, buses, trains, and telecommunications were all publicly owned – their prices set by government and all profits reinvested not given away on fat cat bonuses and dividends. In recent years, utility bills and rail fares have risen way above the level of inflation for little or no discernible service improvements. These price rises for essential services have hit the poorest hardest, and contributed to the growth in inequality to its current unprecedented level.

Make cuts to useless projects

There are several large government projects that are worthy of being cut. Scrapping these projects would be popular, polls indicate, and would allow public money to be better spent elsewhere:

- Stopping the replacement of Trident nuclear weapons would save an estimated £78bn over 30 years
- Abandoning ID card proposals would save at least £6bn
- Bringing our troops home from the pointless war in Afghanistan would save £2.6bn per year, and save countless young lives – British and Afghani

Why the cuts consensus is wrong

A recent IPSOS/MORI opinion poll revealed that only 24% of the British public think there is a need to cut spending on public services. The same poll found that people were most in favour of tax rises on business, closely followed by inheritance tax.

Despite the cross-party consensus, it is clear that people know there are alternatives to public service cuts, and there is a clear belief that those who gained the most from the boom should pay for the bust.

But it's not just that the cross-party consensus is stifling debate about alternatives, the consensus itself is economically illiterate and socially unjust.

The three main parties are particularly targeting cuts to public services, welfare costs, and to the state pension and public sector pensions.

Public services are vital in reducing inequality, by making cuts or increasing charges we will damage the service and ultimately damage our society – taking opportunities away from people. Cuts to university budgets will deny higher education places to people, and encourage calls for higher fees, which would exclude even more. A less skilled workforce is also less attractive to foreign investment, something all three parties regularly declare is vital for the economy.

Cutting public sector jobs will increase unemployment, which in turn will increase the costs to government, as more people claim unemployment benefit and fewer people pay income tax. If people's incomes are taken away or cut (through pay freezes) then they spend less (also hitting VAT revenues). This hurts the economy as there is less consumer spending. It will also result in the private sector cutting back because there is less demand.

Instead, the Government should be creating jobs to boost employment and tax revenue. We have plenty of work to be done. We could invest in renewable energy, high speed rail links, and building new housing for the 1.8m families on council house waiting lists.

The UK currently has the lowest level of unemployment benefit in western Europe – just £64 per week or £51 for under-25s. If unemployment benefit had risen at the same rate as wages since 1979, it would be over £110 per week today. Even if a link between benefits and earnings had been introduced by Labour in 1997, the unemployment benefit would be £75 per week today.

Despite all the horror stories in the press, the government loses three times as much by making mistakes in benefit payments as it loses through benefit fraud. Benefit fraud last year was about £0.8bn, tax evasion by big business and wealthy individuals was £70bn – nearly 100 times as much! Yet where are the posters at bus stops to shop a tax evader?

The basic state pension is still under £100 per week, one of the lowest in Europe. The official poverty level is £165 per week. Proposing to increase the state pension age to 66 immediately and gradually up to 70 would hit the poorest hardest. They earn less and so are less able to take early retirement, and because of this, and a lifetime of lower standards of living, they die younger. With the current unprecedented levels of inequality, raising the pension age is grossly unjust.

The main pensions target for the stale Westminster party consensus are public sector pensions. Currently, the average public sector pension is about £4,000 a year, or about £80 per week – hardly the 'gold-plated', 'feather-bedded' lap of luxury that the tabloids would have us believe.

Two and a half times as much of public sector money is spent subsidising private sector pensions through tax relief – and 60% of this relief goes to higher rate earners at the higher rate.

No way out, whichever way they turn

Gerry Gold[3]

- Neither Keynesian or neoliberal solutions are capable of pulling the global economy out of crisis
- The establishment commentators and institutions are floundering
- This presents a generational opportunity for socialists to articulate an economic and political vision

Financial Times columnist Martin Wolf is one of the best, undogmatic representatives of the old-school, well-intentioned defenders of the capitalist system of production and finance. He stands apart from, and comments on the opposing camps of neo-liberal free enterprise hawks and Keynesian interventionists.

Like the rest of us, Wolf is dependent on the statistics compiled by a variety of organisations. As an analyst he uses the tools of classical economics as well as, and probably better than, most. As an advisor he considers the possible outcomes of the alternative policies and actions proposed by the different camps to those supposedly with the power to act, and makes his own choices – those that might lead to the least worst outcome for the world economy.

In recent months, Wolf has concluded some of his more thoughtful columns with the despairing recognition that nobody (government, central bank, global agency, corporation) seemed likely to take his radical road to redemption. *'The world economy has no easy way out of the mire'*, his column on 23rd February is a case in point. It contains a dense and complex line of argument taking as its starting point analyses and projections published by the Organisation for Economic Co-operation and Development (OECD) last November.

The OECD's role has evolved from helping its membership of 30 rich countries achieve sustainable economic growth and employment, to drawing other countries into the orbit of globalising corporations. It has become a key agency of the transnational capitalist class. In a nutshell, the OECD's latest twice-yearly Economic Outlook No.86 shows that:

- Despite the historically unprecedented injection of public sector cash and credit, private sector spending is running way behind its income. Put simply – consumers aren't spending and businesses aren't investing at anything like the pre-crisis rate
- Bank lending for capital investment – the collapse of which has been used as a key measure of the scale of the financial crisis – has failed to respond to the broad range of stimulus measures implemented by governments around the world.

Fans of financial explanations like to blame the continuing recession on the credit crunch, but as the OECD cautions, the opposite explanation may also be true. It says: "A contraction in bank credit is not necessarily a sign of a crunch in the supply of credit since a deep downturn in activity reduces the demand for borrowing."

The OECD nevertheless looks on the bright side to a 'moderate' recovery from widespread recession, but tries to protect its reputation with a defensive wall of caveats.

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[3] Gerry Gold is economics editor of A World to Win's website and took part in the drafting of *A Manifesto of Revolutionary Solutions* (www.aworldtowin.net)

Things could go very sharply either way, they say: "The uncertainty surrounding this projection is very high, but the risks are broadly balanced."

On the one hand, it says:

"Financial conditions could continue to improve faster and more extensively than assumed, setting in motion a positive feedback loop: better economic prospects and stronger business investment driven by better financial conditions reducing concerns about the health of financial institutions, in turn improving financial conditions, and thereby growth, still further."

But, the opposite is equally possible:

"On the other hand, financial conditions could worsen abruptly, for example, if a large financial institution were to get into difficulty. Unemployment also represents a negative risk to the outlook, as its continued increase may depress household expenditure and negatively affect financial institutions to a greater extent than anticipated. While risks may be roughly balanced, their consequences need not be. With inflation being very low in some countries, a negative shock could push such economies into deflationary territory from which it is more difficult to exit."

These equally likely but wildly opposing possibilities give us only a few clues about the ever-active contradictory forces at work in the depths of the capitalist system, but tell us a great deal about the adequacy of the analytical tools used by the OECD's teams of well-paid analysts. That they clearly have no idea what will happen must surely lead us to take their prescriptions for restoring the system to some kind of health with a very large pinch of salt.

Wolf's 'success' or 'failure' predictions are far more pessimistic. For the world of finance – which, after all, pays Wolf's salary – 'success' means that credit starts to flow to capital investment and the economy begins to return to 'normal'. But this, says Wolf, would soon lead to a new financial crisis, far worse than the one which brought the world to the edge of meltdown in 2008.

And 'failure'? The credit engine fails to reignite and what Wolf calls 'the fiscal rope', the effects of the interventionist stimulus packages, run out. Whatever happens, he says, "either outcome ultimately leads us to a sovereign debt crisis. This, in turn, would surely result in defaults, probably via inflation. In essence, stretched balance sheets threaten mass private sector bankruptcy and a depression, or sovereign bankruptcy and inflation, or some combination of the two."

"That they clearly have no idea what will happen must surely lead us to take their prescriptions for restoring the system to some kind of health with a very large pinch of salt."

Not too cheerful, then.

Predicting a sovereign debt crisis wasn't too difficult. As Wolf was writing his column, Iceland was on its way to a referendum that in March overwhelmingly rejected the terms of repayment of the Icesave debt held by the British and Dutch governments. At the same time, the combined forces of banks, hedge funds, currency traders, European Union and the European Central Bank, as well the German government were ganging up to force savage austerity measures on Greece in an attempt to stop the sovereign debt contagion spreading to Spain, Italy, Portugal and beyond.

The only way out, in Wolf's view is "to use the huge surpluses of the private sector to fund higher investment, both public and private, across the world." It seems like a sensible idea, but what he doesn't tell us is who he thinks might be in a position to do the using, to get the savers spending. He does however admit that nobody looks like going down that route.

The OECD, for its part, thinks the way forward is to begin eliminating the interventionist spending that has propped up car production, for example. It advises its members "to start unwinding crisis-induced policies in an orderly and coherent way" and, ominously, encourages "a renewed drive to implement structural reforms". It says "crisis-driven emergency measures of subsidising production (e.g. in the auto industry) or subsidising jobs (e.g. short time working schemes) need to be scaled back, as their continuation would undermine the productive capacity of the economy."

What the OECD is saying is that nothing must stop capitalist enterprises shutting down unprofitable factories because that's the way the system 'works'. Neither Wolf nor the OECD, nor any of the other purveyors of classical economic analysis, pay much regard to the impact of their policies and actions on the working people whose labour is the source of all value, except insofar as they acknowledge that unemployment will rise and stay high for years, if not decades to come.

In the US, the economic shakeout is driving the rate of exploitation to record levels. Revised estimates from the US Bureau of Labour Statistics show that real hourly compensation fell by 2.8% in Q4 2009, whilst productivity outpaced hourly compensation, causing unit labour costs to fall 5.9% since the previous quarter and 4.7% compared to the previous year, the largest year on year decline in the series' history, going back to 1948. In 2009, productivity rose 3.8% from 2008, while unit labour costs fell 1.7%, a record pace of contraction. There are surely limits to what US workers can stand. An eruption of anger is to be expected in the United States.

In Britain, the devaluation of the pound by 25% in a year has failed to resuscitate the economy and the trade gap has actually widened because overseas markets haven't responded to treatment either. This is increasingly an historic crisis for global capitalism unparalleled in scope and magnitude. The best brains at the OECD and the *Financial Times* can't map a way out because the contradictory forces at work are so powerful and have a momentum of their own. Waiting for the upturn is likely to be as successful as waiting for Godot.

This is a generational opportunity for socialists to challenge the fundamentals of the capitalist system with bold and imaginative policies of democratic ownership and control, both in production and finance. We ought to create a blueprint for transforming the economy from a credit-driven, roller-coaster ride into a rational model that meets ordinary working people's aspirations. Such a project could inspire co-ordinated international trade union action in defence of jobs and conditions, occupation of threatened workplaces and the rejection of spending cuts to 'balance the books'. It would also throw into relief the equally challenging task of creating new political forms to putting these ambitions into practice.

The need for a Manufacturing Strategy

Graham Turner

- The shift from manufacturing towards finance disfigured the UK economy
- As a result the UK trade deficit is growing, and even the relative devaluation of sterling has failed to revive UK manufacturing
- The Tory prescriptions for cuts and free markets are both unpopular and destined to deepen the crisis

For a while, the Conservative Party, aided and abetted by the Liberal Democrats, successfully shifted the economic and political debate away from the causes of the credit crunch to Britain's yawning budget deficit. Both parties have been promising stringent and draconian measures to bring the public sector borrowing down quickly.

The campaign tactic has misfired. The Conservatives have seen their lead in the polls crumble as voters reject the central message of austerity for all. After all, the deficit was not caused by runaway public spending. It was, and remains a direct result of the credit crunch and a collapse in tax revenues, which will be lower this year than any time under Margaret Thatcher or John Major.

And voters are rejecting the Conservative/Liberal pledge to slash public spending, because the real causes of the credit crunch have yet to be addressed. Guided by Lord Mandelson, Labour are at least starting to re-think the disastrous policy of de-industrialisation that led ineluctibly to credit and housing bubbles being the primary motor of growth. When the Conservatives take campaign donations from the City, voters understand that the Tories represent the status quo – a de-liberalised model based around financialisation, which benefits the few and not the wider economy.

Week after week we see companies closing down factories in the UK and shifting production abroad, because workers in this country are no longer 'competitive'. Data from the Office for National Statistics (ONS) underlines the continued slide in the UK towards little more than a nation of bankers. When Margaret Thatcher came to power in the summer of 1979, there were 6.88 million manufacturing jobs. By the time Tony Blair and Gordon Brown had taken over the reins, this had shrunk to 4.19 million jobs.

And the decline in manufacturing became unrelenting under New Labour, as the creation of the World Trade Organisation and the rise of the Asian mercantilists destroyed even more jobs. By the end of 2009, there were only 2.58 million manufacturing jobs left in the UK.

As a share of GDP, manufacturing now only accounts for 13.3% of the economy according to the ONS. By contrast, 'business services and finance' have mushroomed to represent 30.4% of the economy. Manufacturing is so small, that it is even less than the combined weight of 'retail, hotels and catering', which has risen to 14.6% of GDP.

But these ONS figures are based on 2005 data. Following the credit crunch, more up-to-date numbers will eventually show that the UK has an even smaller manufacturing sector. Manufacturing output has dropped 13.8% from its high-point in February 2008, and is currently 11% below its 2005 average.

By contrast, output for business services and finance has been less affected by the credit crunch, even though it originated within the bowels of this sector. The decline from the 2008 peak has been less pronouned, just 6%. Furthermore, the rise in output during the boom was so swift, that even with this drop, business services and finance have still expanded by 8.7% since 2005.

In short, the credit crunch has not stopped the financialisation of the UK economy. The process is intensifying. When up-to-date weights are eventually published for 2009, they may show that business services and finance have expanded to nearly three times the size of our depleted manufacturing base.

It should come as little surprise, therefore, to see our trade position deteroriating yet again, despite a huge decline in sterling. On a trade weighted basis, sterling has fallen by more than a quarter since its peak in July 2007. For a brief while, largely due to the intensity of the decline in consumption, the trade deficit narrowed.

But it is now rising again. The January deficit of £8.0bn, which saw exports fall 8.0% month-on-month in volume terms, may have been distorted by cold weather, preventing goods from reaching the ports. Only when data for February and March have been published we will get a clearer picture.

Nevertheless, prior to January, there were already signs of a renewed increase in the trade deficit, precisely at the time when the adverse terms of trade or 'J-curve' impact of a currency decline, by raising import prices more quickly than export values, should have been fading. The real boost or adjustment should have been coming through quickly, particularly as the some areas of the world economy are enjoying a solid recovery – Asia, Latin America, Australia, Canada, to name a few.

Of course, the trade position depends upon a lot more than exchange rates. Japan has for years lived with a strong currency and still racked up huge trade surpluses. As the world recovers, Japan's trade position is improving quickly, in contrast to the UK. Unemployment is falling in Japan too, dropping to 4.9% in January, having peaked at just 5.6% last summer.

However, Japan has an industrial policy and so does France, a country that has been relatively insulated from the credit crunch. From the peak in Q1 2008, GDP in France has shrunk 2.4%. In the UK, it has dropped 6%. And France did not have the benefit of a competitive devaluation. Since 2007, the trade-weighted euro has gone up.

"a rebalancing of the economy . . . will also provide room for other sectors of the economy to flourish"

Against this backdrop, the TUC is calling for a £5bn French-style fund to make strategic investments in manufacturing companies. The proposal has considerable merit, but is unlikely to be enough in its own right. For one, this would still be dwarfed by a similar fund in France of £17.7bn at Mr Sarkozy's disposal.

Moreover, a rebalancing of the economy to create less uneven growth that benefits the whole country, not just segments of London and the South East, may need to forcibly shrink the financial sector. Bank of England officials have given their tacit support to fiscal measures for precisely this reason. Tighter regulatory, capital and liquidity controls over the banks, are not just a pre-requisite to prevent a return to boom and bust. They will also provide room for other sectors of the economy to flourish. For much of the last decade, before the credit crunch, an outsized financial sector contributed to the overvaluation of sterling by attracting capital flows, which in turn accelerated the loss of manufacturing jobs even when the economy was growing. In short, the ephemeral 'success' of the financial sector came at the expense of manufacturing.

In a globalised economy, shrinking the financial sector, and hoping for further currency devaluation to stem the loss of jobs, will not be enough. The authorities will have set targets, including a policy of balanced trade, intervening in the currency markets against countries (notably in Asia) that continue to rack up excessive surpluses. China is an obvious case. Similarly, a growing number of Eastern European countries are being used as cheap bases for companies seeking to cut costs. The UK trade deficit is rising remorelessly against many of these countries. Ultimately, the threat of protectionism needs to be used to guard against a race to the bottom.

If Labour wants to re-connect with its traditional voters, it needs to spell out its vision for a new industrial policy. It is perhaps ironic that the Conservatives have asked Sir James Dyson to head its task force on how to 'revitalise' manufacturing. The Wiltshire-based entrepreneur famously shifted his production base to Malaysia. The Conservatives, to a one, failed to see the credit crunch coming, and now they do not have a credible industrial policy either. Lord Mandelson needs to be bolder, and articulate his vision strongly. The election is up for grabs.

The Economics of Migration

Jerry Jones[4]

- Weak trade union and employment legislation in the UK, and across the EU, has made it possible for companies to exploit cheap labour
- Over time this has an adverse impact on economic demand, undermines investment and overall economic development
- There is an onus on the left and trade unions to fight attacks against all workers by companies, landlords, the media and government

Immigration will likely be a major issue in the general election. The problem for the government and most mainstream politicians is that they are torn between placating people's forebodings about the impact of immigration on their livelihoods and welfare, real or imagined, which have been fanned by the tabloids, on the one hand, and, on the other hand, the demands of big business, which wants a free rein to recruit foreign workers, either to reduce labour costs or to save the expense of training workers for the skills needed. The challenge for the Left is to demonstrate that problems often attributed to labour migration in fact arise from the current economic system and the neo-liberal economic policies that supine governments in thrall to the big transnational corporations have foisted on the world.

Economic impact of migration in host countries

The economic impact of migration in host countries – and in particular who benefits from it – depends to a considerable extent upon how labour markets are regulated, and on the relative bargaining positions of workers and their trade unions. In general, countries receiving migrant labour tend to benefit because immigrants are typically people of working age, usually young, who bring additional skills and working capacity. But the extent of this benefit depends on migrant workers securing work at the going rate for the job without displacing existing workers. Immigrants will then generate additional wealth, pay taxes to sustain public services and, through their own expenditure, produce additional economic demand, which, in turn, will stimulate investment and employment to meet that demand.

However, if migrant workers displace existing workers, this will have an adverse impact on the economy. There will be no additional generation of wealth, and funds will have to be found to support those displaced workers whose skills might be lost. The effect is even worse if immigrant workers displace existing workers at a lower rate of pay. That is because it will result in lower economic demand, which will mean there will be less incentive to invest in new employment activities and, again, the economy will have to bear the costs of displaced workers.

"A progressive policy on migration needs to be part of an integrated policy for economic development at national and international levels"

In Britain, this adverse impact is now more likely as a result of the anti-trade union laws passed by the Tories in the 1980s, which greatly weakened the bargaining power of the trade unions in Britain. Although some aspects of these laws have been repealed, trade unions in Britain are still in a worse position today than 100 years ago. More action is needed to secure full repeal, so that once again trade unions are in a position to mount solidarity action without having their funds sequestered. This is crucial if wages for both local and migrant workers are to be protected.

[4] A full version of this paper will be posted on the LEAP blog: http://leap-lrc.blogspot.com

Many unscrupulous employers – when they can get away with it – are taking advantage of these weak laws by paying migrant workers at wage rates not acceptable to local workers with families, often below the legal minimum wage. This is believed to be particularly prevalent in agriculture and the construction and hospitality industries.

In 2007, for example, some 5,000 migrant workers from Poland in Herefordshire were discovered to be working 14-hour days, with the highest paid getting just £80 a week, which is far below the Agricultural Wages Board rates that they are entitled to by law. Last year, the GMB union found that migrant construction workers from Italy, Spain and Poland employed by subcontractors at a number of power stations were being paid £1,000 a month less than the nationally negotiated rates, and meanwhile were refusing to employ local skilled workers. Some of these disputes were resolved by workers taking unofficial action co-ordinated over the internet, which trade unions could not support officially because of the anti-trade union laws. As long as these laws remain on the statute book, it might be that this is the form of action that workers must take in order to pressurise employers to pay the rate for the job.

The bargaining position of workers has been further undermined by the Single European Act, now written into EU law under the Lisbon Treaty, such that now, any company within the EU has the right to set up business in any other EU country, and bring in labour from their home country, paying the wage rates of the country in which they are based rather than the host country. We saw this process at work, for example, in the Irish Ferries dispute in 2006, when Irish seafarers were displaced by Latvian and Polish labour being paid a third of the wages. The EU is now seeking to extend such arrangements worldwide in secret negotiations now taking place under the auspices of the World Trade Organisation, through 'Mode 4' of the General Agreement on Trade in Services (GATS). Under the proposals, workers will have neither the customary legal rights they are entitled to in their home countries, nor those of the native workers in the host country.

Another adverse impact of migration in host countries is that the availability of cheaper, highly skilled migrant labour reduces the incentive for firms to invest in training, especially of young people. That is one reason for the current shortage of skilled local workers in Britain, and is why employers are seeking skilled labour from abroad. In addition, this reduces the incentive to invest in technical innovation to raise the productivity of labour. This can only be detrimental to the future development of Britain's economy.

To sum up, if immigrant workers displace existing workers in circumstances where there is a sharp rise in the rate of exploitation – due to radically inferior conditions, longer hours, much lower pay and lower social benefits – immigration will certainly be more profitable for capital in the short run. But over time, because of the adverse impact this has on economic demand, it will undermine investment and therefore overall economic development.

Towards a new left policy on migration

A progressive policy on migration needs to be part of an integrated policy for economic development at national and international levels. A major priority first and foremost must be to wrest control of national economies (and the global economy) away from the transnational corporations and big financial institutions, and restore power to democratically elected governments, able and willing to act in the interests of all citizens, and stand up to the unelected elites that currently dominate. Among other things, this would have to involve controlling not only the international movement of capital, but also of labour, so that both capital and labour can be invested and deployed in the interests of the citizens who create the capital in the first place, and who finance the education and training of skilled workers.

This does not mean the elimination of international capital flows or labour migration, but merely regulating them, so that they operate in everyone's best interests.

A problem here is that unlike capital controls, advocating controls on migration has moral implications. In the case of capital, once it is realised that all capital originates from the appropriation of people's surplus labour, and that it is essentially ill-gotten gains that are being shifted about at the expense of the people who performed the surplus labour originally, it not too difficult to convince people that it needs to be controlled. In the case of labour, however, any restriction on migration is to some extent a human rights issue, because in effect it denies people the right to make a livelihood for themselves and their families as best they can, wherever they can. And for people in underdeveloped countries, because of the chronic shortage of livelihoods due to the underdeveloped state of their economies, the situation is often desperate. Who can deny such people the opportunity to migrate to more developed countries when it is precisely the cumulative effects of international policies promoted by the more developed countries – and their systematic appropriation of surplus labour through trade, through investment and transfer pricing, through debt, and through aiding and abetting capital flight – that are responsible for the underdeveloped state of their countries, and the dearth of decent employment opportunities?

However, the problem of underdevelopment will not be solved through migration. Indeed, it will more likely make the problem worse. The point is that people who leave their local community, friends and even family to seek work elsewhere do not normally do so out of choice, but are compelled to do so by the prevailing economic, social or political conditions in their countries. The task must be to promote economic development, thus to create employment opportunities locally so that people do not need to migrate to seek decent livelihoods.

The role of trade unions and the labour movement

All of what has been said so far would, of course, require a major shift in policy at national and international level. This is what the Left and other progressive forces should be campaigning for in the long run. But what to do in the meantime?

A major priority must be for trade unions to use their collective power to preserve what gains workers have made over the years, both in terms of pay and working conditions, and to prevent employers (and governments in effect acting on their behalf) using migrant labour to undermine those gains. Furthermore, there is the general need for trade unions in different countries to work together to raise wages and labour standards everywhere, especially in the underdeveloped countries, thus shifting the balance of income going to wages at the expense of capital. This would help raise economic demand globally, which, in turn, would provide the stimulus to invest in new productive activities, thus creating new employment opportunities.

Secondly, trade unions need to campaign for a minimum wage at international level, and to get it raised as economies grow (which would make them grow all the more). This argument would have more weight once the current neo-liberal policies are defeated. For instance, if import controls were introduced, it would mean that the additional economic demand created by raising the minimum wage would go straight into investment and jobs in the domestic economy.

In addition, trade unions need to ensure that employers comply with minimum wage regulations, and not get round them by making spurious deductions from workers wages, and the like, which has been the practice among a number of employers of migrant labour in

Britain. In fact, as a result of some of these abuses being widely publicised, the government supposedly has tightened up its vigilance against rogue employers and introduced higher fines for non-compliance – which, paradoxically, is being supported by the very employers' organisations that were originally opposed to the minimum wage, because employers obeying the law do not want to lose out to those getting round it.

Thirdly, trade unions need to recruit migrant workers in order to protect their interests as well as the interests of local workers. The International Centre for Trade Union Rights has produced a useful pamphlet, *Organising migrant workers in trade unions*[5].

Finally, the trade union movement and other progressive forces need to address problems arising from migration, especially in areas of high or sudden immigration, where local tensions between different cultures can be fanned by employers trying to cheapen labour and push down wages, by landlords buying up properties and collecting exorbitant rents from multi-occupation, and by the lack of investment in social housing and in schools which may suddenly find themselves having to cater for large numbers of pupils whose native language is not English. The progressive and labour movement response must be to oppose making migrant workers and immigrants the 'scapegoat' for exploitation, inadequate planning and the lack of public sector finance, and to campaign for more affordable social housing to be provided in order to meet the needs of both local and incoming people, and for extra educational provision.

[5] Available from International Union Rights, 177, Abbeville Road, London SW4 9RL. See also www.ictur.org

A Peoples' Budget Needed

John McDonnell MP

Individual budgets seldom make a tremendous amount of difference to the overall long term trajectory of an economy. Usually it takes a sequence of budgets and major public expenditure decisions to set a new agenda for the economic direction of a country. This year's budget could be an exception, coming as it does before a general election.

When people vote in the coming weeks they should be able to make a clear decision on what path they wants their government to pursue in tackling the economic crisis caused by the credit crunch. In the election they should be able to decide whether those to blame for the economic crisis should pay for it and how? Whether we are content for the system that proved to be crisis ridden to remain largely unchanged or whether it should be radically reformed? Whether the organisation of society, our democracy, our institutions and our values, facilitated the development of this crisis system and what alternatives there are?

The alternative budgets promoted by the political parties should offer the electors a range of answers to those questions. The problem is that it is virtually certain that they won't. Undoubtedly there will be differences between the main parties about the scale and timescale of public expenditure cuts and cuts in wages and conditions for workers in both the public and private sectors but the answers to the questions of who pays and what organisational and systemic changes are required will all be within the same parameters.

They have agreed between themselves that the people will pay, the financial system will largely remain unchanged and institutional reform will be at the margins. To those that question this consensus the response is usually that the system is too complex for us to either understand or change. Bizarrely the argument goes that anything more radical than minor adjustments will lose the confidence of the very markets whose behaviour actually created the economic crisis in the first place.

"A programme of real reform is needed to take democratic control of our financial and economic institutions based upon the principles of public and common ownership"

There are a different set of answers to these questions, which we are all capable of understanding and which are readily implementable, given the political will.

The people and institutions that should pay for the crisis are the ones that caused it and who not just profited from it but are largely continuing to do so. The method of making them pay is by introducing a tax system that tackles tax evasion and avoidance and redistributes wealth fairly.

The system that caused the crisis is no longer sustainable, especially because of its planet threatening environmental consequences, and therefore to prevent further crises we have to gain control of the system. The best means of controlling institutions we have invented so far in our society is democracy, often linked to public or common ownership. A programme of real reform is needed to take democratic control of our financial and economic institutions based upon the principles of public and common ownership.

The Government could use this week's budget to demonstrate that it is taking the first steps along the path of offering a real alternative economic strategy. Introducing a budget for the people rather than for the system could then open up the wider debate in the general election about how our political system colluded in allowing this crisis ridden system to develop and what political and social changes are now needed.