

# Restoring the Public

## Budget report – March 2011

### The Public is not the Problem

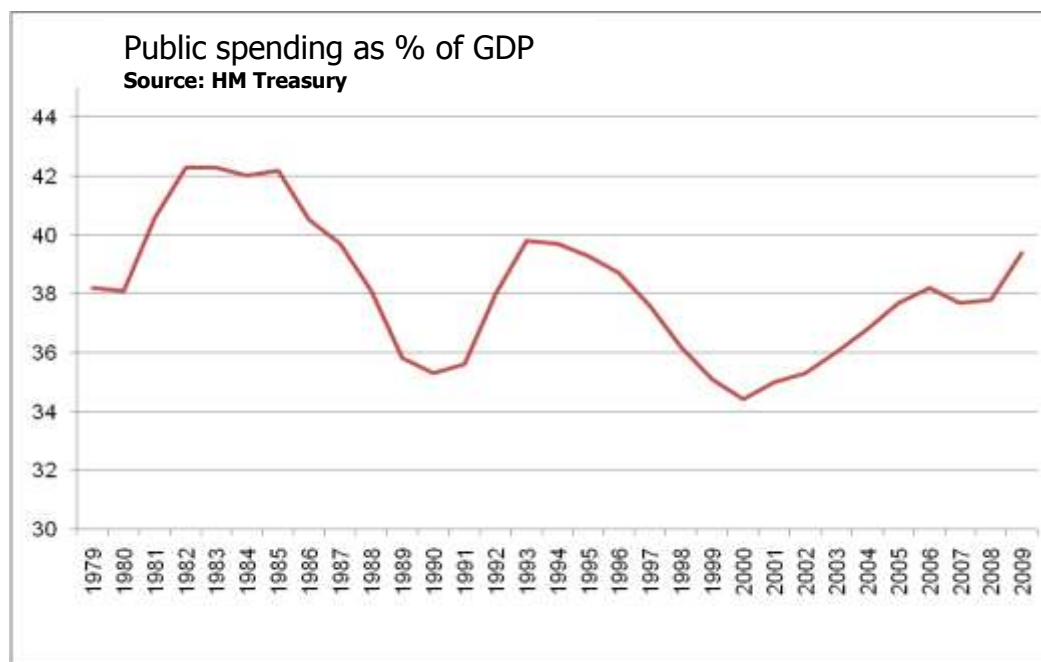
The Chancellor George Osborne explains both the cause of the UK financial crisis and the solution to it by the same means. Osborne argues that a bloated public sector has been 'crowding out' the private sector.

*"An economy where the state does not take almost half of all our national income, crowding out private endeavour"* – George Osborne, June budget

In short his argument is that that government is using resources – taxes (capital) and workers (labour) – which would be more effectively and productively used by the private sector.

His remedy is therefore to slash the size of the state (over £80 billion of cuts in the Comprehensive Spending Review, Oct 2010), and cut business taxes (£24 billion of corporate tax breaks in the Emergency Budget, Jun 2010). This, Osborne argues, will mean businesses will grow, the economy will flourish, and the crisis will end.

There are several problems with Osborne's narrative. As the graph below shows public spending as a percentage of GDP was actually higher under Thatcher and Major than it was under Blair and Brown.



Excessive public spending by New Labour is a myth. So Osborne is wrong that crowding out caused the crisis.

It's not just that Osborne is wrong, but that the exact opposite of what he argues is actually the case: the cause of the crisis was the private sector crowding out the public sector – and this remains a source of instability, so that the solution to this crisis is for the public sector to reoccupy the space taken by the private sector.

### **The real problem: Unemployment**

The problem of the deficit cannot be solved by cuts. Hacking away at spending – as Osborne is doing on an unprecedented scale – is reminiscent of the amputating of the infected parts of the body by medieval quacks, who are then bemused that the patient then dies. In fact in Osborne's case it's worse: he has misdiagnosed the illness too.

The real problems in the short-term for the UK economy are high and rising unemployment, and cuts in capital expenditure.

As Professor Joseph Stiglitz recently argued, "the solution to the deficit problem is putting America back to work and austerity measures go exactly in the opposite direction". We need to act fast to create jobs here too. Osborne's unfounded faith that the private sector will automatically create jobs if public sector spending and jobs are cut is proving wrong. It is effectively a laissez-faire labour market policy.

Unemployment is now 2.53 million, its highest level since 1994. No economic forecasters are predicting unemployment doing anything but rising in 2011. The only disagreement is whether unemployment will reach 2.8 million or 3 million in the next nine months.

But even the ILO measure of unemployment understates the problem as there are a further 1.7 million involuntarily working in temporary or part-time jobs (i.e. looking for more work). In total then there are over 4 million people looking for work.

As John Grieve Smith argues in his background paper<sup>1</sup>, Labour should "make the reduction of unemployment a key objective in determining its approach to the budget deficit, public expenditure and taxation", and this should mark a return to a policy of full employment – which has already been discussed by Liam Byrne and Ed Balls in recent weeks.

### **An interventionist investment policy**

The only way to guarantee jobs is to invest – and this requires capital expenditure. Osborne however will cut capital expenditure by 4% next year, and by a further 6% the following year.

This does not include the cuts to capital expenditure which have been forced on local government by the draconian front-loaded cuts there. Research by CIPFA shows that 28% of councils are cutting their capital investment projects by 30% or more. On top of that, 12% of councils are making cuts to economic development and regeneration projects of more than

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<sup>1</sup> See Grieve Smith, J. 'Keynesian consensus equals a constructive advance'. LEAP blog, 20/03/11  
<http://leap-lrc.blogspot.com/2011/03/keynesian-consensus-equals-constructive.html>

30%. Given that the cuts are hitting poorer areas hardest, it is likely that these councils are in the most deprived areas, where unemployment is already high.

There is no shortage of capital expenditure projects that could be proposed and funded. There is a chronic housing shortage in many areas, an urgent need to heavily invest in renewable energy, and a range of transport infrastructure projects. The 'One Million Climate Jobs' pamphlet sets out a range of job-creating investment opportunities<sup>2</sup>.

## A Windfall Tax

As an immediate measure, LEAP is proposing that a windfall tax is levied and hypothecated to just such projects.

The targets for this tax should be the companies and sectors that have been guilty of profiteering in the recession. They are the banks, supermarkets and energy companies. We set out the reasons below for each.

**The banks:** A report by Moneyfacts in August 2010 showed the profit margins enjoyed by the banks on fixed rate deals are the highest since 1988. Mortgage and other lenders are being hit with high interest rates, while savers are getting very small returns. The report found that "the average rate of interest charged on personal loans is 12.6%, meaning the margin it sits over the base rate of interest is 12.1% - an all time high. The same is true for credit cards which, charging an average interest rate of 18.8%, sit 18.3% above the Bank of England's measure"<sup>3</sup>.

**The supermarkets:** Ironically, it is a bank that is pointing the finger at the supermarkets. The UBS report into UK supermarket prices increases found "commodity price inflation in the past few months would justify a 3-3.5% increase in processed food prices, but supermarkets have increased prices by 6-6.5%." The report's co-author said "there may be margin expansion in the supermarket sector... Prices are rising in excess of justifiable cost increases."

**The energy companies:** The unusually cold winters in the past two years, and large margins, have led to bumper profits for energy suppliers such as British Gas, whose profits rose by 24% in 2010. The regulator Ofgem has found that energy companies increased their net profit margin per customer by 38% last November, and is currently reviewing energy prices. However the case for a windfall levy now is not in conflict with future recommended reforms to regulation.

On a conservative estimate, we believe that these windfall taxes could raise between £3.5 billion to £7 billion. As an example of how the funds could be spent we suggest a 'Warm Nation Project' (see page 4) based solely on the receipts from the windfall tax on energy companies.

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<sup>2</sup> See <http://www.climate-change-jobs.org/node/14>

<sup>3</sup> See <http://moneyfacts.co.uk/news/banking/bank-margins-at-record-levels/>

**Energy windfall: Warm Nation Project**

**Approximately one-quarter of the windfall total is from the energy sector, so between £850 million and £1.7 billion would be available for a ‘warm zone project’, based on the Kirklees model where “every home in Kirklees which was suitable for loft and cavity wall insulation received this work for free” over a three year period at a cost of £20 million.**

**Based on the Kirklees figures, the lower estimate windfall levy could fund visits to 7.25 million UK homes. A project on this scale would include every single one of the UK’s 6.5 million pensioner households.**

**As well as creating tens of thousands of jobs, it would also provide an economic stimulus as pensioner households would spend less on energy bills.**

**Sustaining the spending**

Critics will rightly argue that windfalls are one-off incomes not sustainable spending. We believe that these projects will help reduce government spending on social security and increase the tax base as jobs are created.

**Closing the tax gap**

However, by committing to starting now on a serious clampdown on tax evasion, closing the tax avoidance loopholes, and investing in HM Revenue & Customs the government could close the £120 billion annual tax gap. A tiny proportion of the windfall could be invested in this way and would more than pay for itself. As compliance increased so funding for projects could be continued and expanded.

**Financial Transaction Tax**

LEAP also supports the introduction of a financial transaction tax – popularly now known as the Robin Hood Tax<sup>4</sup>. The role of such a tax is not simply revenue-raising, but compensating for when currency speculators act in anti-social ways.

Richard Murphy explains how such actions have added to the crisis in Japan

“There has been massive speculation in the Yen since the Japanese earthquake / nuclear disaster began to unfold just over a week ago. A massive surge in the Yen, on the assumption that Japanese companies will be bringing assets back to Japan.

“But Japan is also a net exporting nation so the move would also be massively harmful to its economy just at a moment when it is already in deep trouble.”<sup>5</sup>

While a financial transaction tax would not necessarily have stopped such speculation, it would raise revenue to compensate for it. The Japanese deputy finance minister rightly railed against “speculators who act like sneaky thieves at a scene of a fire”.

**The Case for a Land Value Tax**

LEAP is a long-time supporter of Land Value Tax (LVT)<sup>6</sup>, to shift the burden of taxation away from earnings and consumption and towards wealth.

<sup>4</sup> See <http://robinhoodtax.org/>

<sup>5</sup> See <http://www.taxresearch.org.uk/Blog/2011/03/19/banks-sneaky-thieves/> for full article

<sup>6</sup> For more information see the Labour Land Campaign: <http://www.labourland.org/>

The case for LVT is summarised below:

- LVT is unavoidable – land cannot be stored offshore so avoidance and evasion is more difficult
- LVT is a progressive tax that would treat tenants and freeholders more equitably
- LVT assists communities and the economy by bringing unused and underused land back into full use – and would reduce land hoarding and speculation (this is particularly pertinent since some reports suggest that Osborne is planning to reinstate rate relief on empty commercial properties)
- LVT is a green tax that will lead to more efficient use of land and negate the need for urban sprawl and more Greenfield development

We therefore recommend that a commission is setup to identify how LVT would fit into the overall tax framework – and which taxes could be scrapped or reduced to compensate.

## Conclusion

***John McDonnell MP***

With 2.5 million unemployed already we are facing the prospect of 3 million jobless by the end of the year. One million of the workless are young people under the age of 24, one and a half million people are in enforced part time work and the job losses resulting from the Government's expenditure cuts have yet to kick in. This level of increase in unemployed people takes an enormous slice of demand out of the economy. If you then combine the job losses with pay freezes and pension and benefit cuts and add to that the increases in the costs of basic goods such as food, heating and fuel, we are presented with all the ingredients for a dangerous spiral of deflation.

The deflationary spiral is blindingly obvious. People with less to spend faced with rising prices of essential goods have little to spend on anything else and the demand for consumer goods and services falls, with the result that more people get laid off, causing a further fall in demand and we go round in another vicious spiral of deflation. All this is so familiar and so understandable and yet the Coalition Government continues to succeed in persuading large sections of our society that cutting public spending and sacking people is the only answer to tackling the economic crisis.

As they see their services cut and as they lose their jobs more and more people are beginning to understand the implications of the Government's economic policy and are looking for an alternative.

LEAP's budget proposals provide the basics of this alternative. In the short term we can close the deficit relatively easily by taxing those that are profiteering in this economic crisis, that is the bankers and speculators, the energy companies and the supermarkets. In the medium term it involves tackling tax evasion and avoidance, increasing corporation tax, bringing in a Robin Hood transaction tax and implementing a Land Value tax.

As the taxes come in we not only solve the deficit but we can also use the funds to put people back to work on greening and growing our manufacturing base to rebalance our economy<sup>7</sup>. Demand is increased and by increasing demand we get onto a virtuous economic cycle. The alternative is straightforward enough. We now need to bring this Government down so that we can implement it.

### **Acknowledgements**

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**Their contributions and involvement should not be taken as their personal endorsement of every proposal contained herein – which are solely those of the Editors: Andrew Fisher and John McDonnell MP**

<sup>7</sup> For further information see LEAP Budget 2011 background paper Turner, G. 'Global Economic Outlook'. March 2011. <http://leap-lrc.blogspot.com/2011/03/budget-2011-global-economic-outlook.html>