

The Cuts

Red Papers

December 2009

- **Graham Turner** on Britain's macroeconomic situation
- **Gerry Gold** on whether we need a finance sector
- **Jerry Jones** on reviving Britain's manufacturing industry
- **Andrew Fisher** on the cost of asset sales and the private sector
- **Richard Murphy** on the cost of public sector cuts
- **Dave Wetzel** on why the UK needs a land value tax
- **John McDonnell** on an alternative to cuts

Edited by Andrew Fisher

Contents

Cuts: an easy alternative to systemic change Editorial	3
Is Britain turning Japanese? Graham Turner	4
The Finance Sector: What is it good for? Gerry Gold	8
Reviving Britain's Manufacturing Industry Jerry Jones	10
Everything must go? Brown's asset sales assessed Andrew Fisher	15
The Cost of Public Sector Cuts Richard Murphy	17
The UK needs Annual Land Value Tax Dave Wetzel	21
It Doesn't Have to be Cuts, There are plenty of Alternatives John McDonnell MP	24

Cuts: an easy alternative to systemic change

The label of choice for the current systemic turmoil has evolved from the 'credit crunch', 'global economic crisis' and 'recession' to 'public sector debt'. This is quite an achievement.

The finance sector that brought the global economy to its knees in 2008 and 2009 will be written out of the story in 2010 as a new consensus solidifies among the political elite, parroted by the mainstream media, that the real crisis is public sector debt.

Despite the fact that the private finance sector collapsed in a heap of fraud and lies, and was bailed out by the public sector, it is now the public sector that is routinely labelled 'wasteful', 'bloated', 'feather-bedded' and 'out-of-control'.

While calls have been made for systemic changes in the global financial order and to the UK banking sector – even by Government ministers on occasion – the pre-existing regulatory structure remains largely unchanged.

The problem now is the public sector. By taking on all that debt created recklessly by the private sector, the public sector is now in trouble. Banks were 'too big to fail' yet no area of the public sector will emerge unscathed from the UK cross-party consensus.

The message is clear: banks (and all the bonuses, profligacy and speculation that go with them) are essential; healthcare, education, welfare, and pensions are all to be sacrificed on the altar and offered up to the Gods of neoliberal orthodoxy.

These papers therefore set out an alternative to this madness which currently sets the political and media agenda.

Graham Turner analyses the current macroeconomic conditions in the UK, and draws the lessons from Japan's experience, while **Gerry Gold** asks why we need a finance sector (and which parts of it) – an important question given the unprecedented levels of public expenditure that have supported it. Conversely, **Jerry Jones** looks at an industry that has been underinvested and has waned as the finance sector grew in the last three decades: manufacturing.

In separate ways, both **Richard Murphy** and **Andrew Fisher** spell out the economic illiteracy of attacking the public sector as a solution to the crisis: Richard by showing the costs of making public sector workers unemployed; and Andrew the costs of asset-stripping the public sector.

In the final papers, **Dave Wetzel** and LEAP Chair **John McDonnell MP** posit alternatives to cuts. Dave proposes a land value tax, and John an alternative policy programme.

Andrew Fisher
Editor, *LEAP Red Papers*
December 2009

Is Britain turning Japanese? Graham Turner

A defunct banking system, spiraling government budget deficits and an economy mired in recession. This description of the UK economy sounds all too familiar to those who followed Japan closely during the 1990s. The parallels are indeed troubling.

Japan tried to spend its way out of trouble, incurring record budget deficits that were buttressed by quantitative easing. A brief recovery from 2003 onwards was cut short by the credit crunch. And now, the Japanese government's public debt burden is racing towards 200% of GDP, nearly three times that in Britain. Deflation has intensified to fresh highs, and wages are being slashed. Property prices across Japan have continued to slide uninterrupted for nearly two decades.

It is a sorry state of affairs that reflects a series of policy mistakes, which are being repeated not just in the UK but also in the US. There is time for policy makers to reverse tack. However, there is a real danger that the 'Anglo Saxon' world will be blighted by the Japan economic disease for years.

For years, Japan was dismissed as an idiosyncrasy by Western commentators. Many claimed the country's problems were unique and that 'it could never happen here'. Some even reveled in the sudden downturn in Japan's fortunes. The remarkable rise of Japan from its defeat at the end of the Second World War had left many in awe. The spectacular growth of Japanese industry and the world domination achieved by so many of its leading companies had been viewed with considerable envy.

When Japan's bubble burst in early 1990, the Bank of Japan was slow to cut interest rates. Japan's central bank had become obsessed with the spectre of inflation and it failed to cut interest rates quickly. The threat of a deflation spiral was completely overlooked.

Frustrated by the Bank of Japan's inaction, the Japanese government responded by trying to reflate through demand management or Keynesian policies. Virtually every fiscal policy option was tried in a bid to end the decline. The first emergency supplementary budget was introduced in the spring of 1992. A total of ten emergency budgets had been crafted, worth a massive ¥124.6 trillion before Prime Minister Junichiro Koizumi came to power in April 2001, calling a halt to the great 'Keynesian' experiment. Large sums were pumped into building new roads, bridges and dams to keep construction companies in business.

But it was all to no avail. No matter how hard the politicians tried, the economy would only respond for a short while before slipping back into recession. The failure of fiscal policy to reverse the decline did not deter them. Politicians reasoned that if they did not try, the situation would be even worse.

The experience of 1997 in particular convinced many that the government had no choice but to keep incurring record budget deficits, otherwise Japan would slip further into difficulty. The tax increases of that year – the consumption tax (similar

to VAT) went up from 3% to 5% – were followed by an alarming dip in the economy. The decision to tighten fiscal policy was blamed by many for pushing the country back into recession.

It is an argument peddled by Richard Koo in “The Holy Grail of Macro Economics”, a book cited by many commentators today in defence of fiscal profligacy. His analysis is wrong.

A number of economic indicators suggest that the Japanese economy was in trouble well before the tax hikes took effect. And significantly, Japan suffered the first of five major bankruptcies in the life insurance industry. The failure of Nissan Mutual Life Insurance in the spring of 1997 caused people to panic, pushing the savings rate up sharply. The South East Asian crisis then struck. But none of this gets a mention in Koo’s book, which has become the bible for those advocating relentless fiscal stimulus to keep the economy on life support.

Koo and many others also cite the 1930s to support their assertion that big budget deficits are necessary for an economic recovery. Historical evidence does not support their case. The primary tools for reversing the Great Depression were an aggressive monetary policy combined with extensive restructuring of the banking system. The US economy turned up in 1932 in response to quantitative easing. Bank recapitalisations in the spring of 1933 then added momentum to the recovery. The War Loan Conversion in the UK, a similar policy to quantitative easing, was critical in turning the tide in the UK. Abandoning the Gold Standard in both countries helped too.

But the role of fiscal policy was secondary. The budget deficit rose to a peak of just 5.1% of GDP in the US and 5.0% of GDP in the UK, during the early 1930s. The contrast with today is stark. On current projections, the US administration may run a deficit more than double this in financial year 2010. The UK is on track to run a deficit of more than 13% of GDP this year.

Too many economists and politicians have invoked Keynes to justify the aggressive use of fiscal policy, without realising – or admitting – that this was not his prescription. For much of the early 1930s, his time was devoted towards the correct debt management policies that would support a recovery. Keynes was first and foremost a monetary economist. His work on liquidity preference and the difficulty central banks faced getting borrowing costs down when asset prices collapse were the most important of his many practical contributions to economic policy during the early years of Great Depression.

But much of this was overlooked during the post-war era. Keynes was cited by those who wished to promote fiscal stimulus to drive economic growth, while ignoring many of the underlying structural problems, including the persistent downward pressure on wages that ultimately reared their head during the credit crunch.

The Bank of England would rightly argue that its aggressive use of quantitative easing has indeed adhered to the 1930s textbook. Even if the budget deficit has been allowed to rise far beyond that seen in the early 1930s, extensive buying of

gilts has produced a powerful monetary response that should, in theory, see the economy emerge from recession in the fourth quarter of this year.

Adam Posen, a recent recruit to the Monetary Policy Committee, gave an articulate defence of quantitative easing in a speech at City University last month, rightly admonishing critics who warn that 'printing money' will inexorably lead to higher inflation. With wages being squeezed so hard, a resurgence of inflation remains a distant prospect. Even though the headline CPI may rise above 3% early next year, this is very modest given the scale of sterling's decline since 2008.

However, Mr. Posen did also highlight the limits of quantitative easing in an economy like the UK, where too many of its banks are too large – and broken. The UK may be a 'world leader' in international finance but, Mr. Posen warns, the banking system is ill-equipped to support companies that do not have access to capital markets. Quantitative easing works by driving bond yields down, both for the government and for companies. Buying government debt – or gilts in this case – has a very direct impact on yields, if done on a sufficient scale.

GFC Economics has been vocal in its support for quantitative easing. Indeed, when our book *The Credit Crunch* was published in June 2008, the warning was explicit. "There is only one monetary policy option that is likely to work at this late stage. That is quantitative easing".

When the policy was finally unveiled in March this year, we argued it was necessary, but it would not be a panacea. Two risks were apparent. Borrowing costs might fall, but because the banks were so weighed down by non-performing assets, the recovery might still be slow. Mr. Posen gave a good critique of the structural problems within the banking system that any incoming government will need to address next summer.

The second problem remains entwined with the first. The US Federal Reserve (Fed) has plainly not learnt from the 1930s. The Fed chair, Ben Bernanke, has been widely touted as an expert on the 1930s, but closer inspection of his academic work shows a limited understanding of monetary policy during this era, and in particular the role of quantitative easing.



The Obama administration has failed to address the foreclosure crisis too. The latest National Delinquency Survey in the US made for grim reading. By the end of September, one in eleven homeowners with a mortgage was either in the process of being repossessed, or seriously in arrears (more than three months, see chart left).

Despite repeated bailouts, capital injections and tax-subsidised incentives, the homeless crisis is

intensifying. The banking system is failing to support a recovery in the US too. Real GDP may have risen in the third quarter, courtesy of tax giveaways, but the US faces an economic and political crisis in 2010 if President Obama does not tackle the housing debacle.

That is perhaps ironic, as critics of Japan often claimed banks were too slow in recognising their losses, which exacerbated the deflation spiral during the 1990s. By contrast, it is claimed that the losses have been acknowledged sooner in the UK and US. And yet, credit is still contracting in both countries. Owning up to bad debts does not automatically presage a recovery, if banks are not willing to lend and are busily defaulting on borrowers: in a deflation spiral that simply creates more bad debts. And the UK banks may have more nasty surprises in store for the UK taxpayer, if property prices in the US – commercial and residential – continue to slide next year.

Alternative avenues to get credit flowing are needed if the UK is to avoid a double dip. The current Labour government is trying to inject more competition in to the banking sector, allowing new entrants, but these are long term solutions to a chronic over-concentration of the finance industry – which it has long supported. State backed, democratically accountable institutions offer an alternative route. But again, time is of the essence.

Ultimately, the UK government needs to recognise the role it can and should play as the major shareholder of RBS and Lloyds/TSB, and forget trying to prepare these banks for an early return to the private sector. The banks are currently being run on commercial lines. Shrinking balance sheets and raising margins is the inevitable private sector response to a credit crisis. But more direct control of these institutions might allow the flow of credit to smaller and medium companies to resume, putting the economy in better shape to withstand a double dip in the US, and a necessary tightening of fiscal policy in the UK.

Graham Turner, *The Credit Crunch, Housing Bubbles, Globalisation and the Worldwide Economic Crisis*, Pluto Press, 2008, and *No Way To Run An Economy*, Pluto Press, 2009

Richard Koo, *The Holy Grail of Macro Economics, Lessons from Japan's Great Recession*, John Wiley & Sons, 2009.

The Finance Sector: What is it good for?

Gerry Gold

In the run-up to the 2012 Olympics, the New Labour government is hot favourite for victory in the financial events. Its bailout of the Royal Bank of Scotland (RBS) – so far amounting to a world-record £53.5 billion since the onset of the crisis in 2007 – is the major part of the total £74 billion of taxpayers' money the government has put into the banks, including RBS, Lloyds and HBOS, since the start of the financial crisis.

The increasing size of the bailouts shows one thing – the crisis is getting worse rather than better. The latest £25.5 billion for the RBS is part of a second bank bailout which adds up to £39.2 billion. This includes a smaller handout to Lloyds, but is overall £4.2 billion more than the 2008 amount. The Government is hoping this will keep the banks afloat whilst they tear themselves apart under instruction from the European Union's competition rules.

The dismemberment of systemically important 'too-big-to-fail' banks is a hot topic for the world's financial community, but there is no agreement on a co-ordinated package of regulation and reform. Some want to return to the regime established in the wake of the 1929 crash which separated high-risk investment – gambling – from the safer, but less profitable business of balancing deposits and lending.

Others, like the International Monetary Fund, are busy trying to work out how to reduce the grossly unsustainable government deficits resulting from attempts to prevent global meltdown. All of the schemes under discussion concentrate their attention on repairs to the financial system.

Mervyn King, Governor of the Bank of England, in a speech to Scottish business organisations, noted: "The sheer scale of support to the banking sector is breathtaking. In the UK ... it is not far short of a trillion (that is, one thousand billion) pounds, close to two-thirds of the annual output of the entire economy. To paraphrase a great wartime leader, never in the field of financial endeavour has so much money been owed by so few to so many. And, one might add, so far with little real reform". He went on: "It is hard to see how the existence of institutions that are "too important to fail" is consistent with their being in the private sector".

In his own way, King was questioning the *raison d'être* of the capitalist financial system. It is a question we need to ask. What exactly is the financial system for? What benefits does it bring to the majority of the six billion people who inhabit the planet? Why should it be bailed out? Have the institutions that make up the financial system passed their use-by date? Has the entire basis for their existence – support for the making of profit – receded into history?

Rather than resolving the contradictions between productive and finance capital, 50 years of globalisation have intensified them to breaking point. Post-war capital expansion funded by Keynes-inspired government funding ran into crisis in the late 1960s as the rate of profit fell. The loosening of regulation needed to allow the expansion of capital needed to mitigate the crisis produced transnational corporations trading on global markets via an international financial system.

The resultant massive increase in output of cheapened commodities not only further intensified pressure on profit rates but required a massive increase in consumption far beyond the means of workers' wages. Easy credit became necessary to facilitate the age of debt-financed overconsumption. So, the unprecedented expansion of finance was necessary to facilitate the expansion of capital itself and its market, to pursue the path of growth that has driven the exploitation of the planet's resources to the limits.

Growth needed finance and finance induced growth in a mad dance of mutually assured destruction. In the hysteria accompanying the myth of growth without limits, the players in the financial system became virtually and virtuously parasitic, recycling debt throughout the 24 hour global networks like there was no tomorrow. As it turned out there wasn't. Debt exploded beyond the ability of ordinary people to meet their repayments. When they stopped paying mortgage interest the system went into a tailspin. The bubble, as they say, burst.

The intertwined crises of collapsing consumer demand, shrinking global trade, declining manufacturing and inactive credit markets spell the end of the post-war era of a spiralling growth of commodity production fuelled by cheap labour and induced by debt. The overhang of state, personal and banking debt makes a 'return to growth' impossible. No new jobs are being created or will be. Mass redundancies will accelerate the rate of house repossessions, more pensions will be destroyed.

The way the financial sector collapsed into the arms of the state shows that both it and the system of production for profit it supports are no longer viable. Bankers thumb their noses at attempts to limit their bonuses to show that the system can neither be regulated nor reformed. The short shrift given to Gordon Brown's support for a Tobin tax on transactions shows who is in charge.

Rather than trying to patch up a broken system by bankrupting the population, a government which is serious about solving the crisis would set about:

- shutting down speculative areas like stock markets, hedge funds, the carry trade in foreign exchange
- outlawing gambling in the derivatives casino
- replacing the entire for-profit financial system with a not-for-profit network of socially-owned financial institutions providing essential services. Many examples of these already exist: mutually-owned building societies, credit unions, the Co-operative bank
- establishing democratic control over the finance system, so that decisions can be made about which debts can be cancelled and which renegotiated: mortgages, for example could be renegotiated on the basis of the greatly reduced and declining market values

With the elimination of private equity shareholding, and the abolition of speculation on the money markets, the techniques developed by global capitalism can be used to clear payments between enterprises within and between countries. Accounting systems can be used and further developed to be open to public scrutiny. The dream of a moneyless, socialist society can become a reality.

Reviving Britain's Manufacturing Industry

Jerry Jones

Britain desperately needs to revive its manufacturing industry. Compared with other advanced economies, Britain's economy is overdependent on the financial sector. For example, bank holdings in Britain amount to over 300 per cent of GDP, which is double that in the Euro area, and four times that in the US. And, since the current crisis largely originated in the financial sector, Britain's economy is likely to be hardest hit. Indeed, debt write-downs by banks based in Britain during the coming period, according to IMF estimates, will amount to some 25 per cent of GDP. This compares with only 6 per cent in the Euro area, and 7 per cent in the US. Britain, of course, invented manufacturing industry. But ever since bankers and others in finance, in the late nineteenth century, discovered that they could make more money overseas than investing in Britain, manufacturing has tended to be neglected. Other countries are not forever going to allow financial institutions based in the City of London, acting as an offshore tax haven, to benefit at their expense. Britain needs to diversify.

The Government had the chance to kick-start the revival of manufacturing when it was forced to rescue three of Britain's high street banks facing bankruptcy. The banks could have been taken wholly into public ownership and used as a conduit for channelling the funds created by the Bank of England in its so-called 'quantitative easing' programme to invest in manufacturing. That is what the authorities did in China through its state-owned banks, and its economy has carried on growing. In Britain, in contrast, the funds created have been stuck in banks, used mainly to strengthen their balance sheets, instead of being invested in the real economy, which is what is needed to overcome the crisis.

Some immediate investment priorities

For a start, the funds could have been invested in a major house-building programme. This would have killed several birds with one stone. First, this would have helped overcome the chronic shortage of affordable homes, without which, with numbers seeking homes on the increase in the coming period, the situation will go from bad to worse. Second, it would have provided jobs for the thousands of unemployed construction workers. This, in turn, would have created economic demand for goods and services on which the newly employed builders would seek to spend their wages, stimulating investment and employment in their production and supply. Furthermore, investment in construction would have stimulated investment and employment in the manufacture of the various inputs required by the revitalised construction industry. In addition, the new employment and spending created would have boosted tax revenues, thus enabling the government to recoup much of the money spent.

Another use of the funds could have been to extend investment in infrastructure, especially the railways, which are desperately backward compared with most other advanced countries. This would have had similar knock-on effects. Moreover, investment in infrastructure (and also to some extent in construction) feeds directly

into land values, which could be recouped through a land value tax that would make the investment self-funding.

Another important area for public investment is in the development of renewable energy technologies, much needed if Britain is to achieve its targets of reducing carbon dioxide emissions. Some experts have estimated that as much as 80 per cent of Britain's energy needs could come from a vast network of offshore wind farms. This would obviate the need for nuclear power stations, with all the hazards involved – which, in any case, if one takes account of the whole process from mining to the production of the nuclear fuel and dealing with the radioactive waste, emit as much carbon dioxide as conventional power stations. (Ministers try to cover themselves here by inserting the phrase 'at the point of generation' when referring to the supposed benefits of nuclear power).

There are many other areas of manufacturing that the government could foster to create jobs and skills, and to promote faster economic growth with minimal environmental impact. But for this, a coherent strategy is needed.

The need for a new international trade policy

First, it needs to be pointed out that if the Government were to pour funds into construction and manufacturing, this could simply benefit other countries at our expense by drawing in imports. If the economy is to expand, Britain will need to import, but it needs to be ensured that what is imported has the greatest economic impact. In other words, there will need to be import controls. This, of course, will immediately bring howls of 'protectionism', so indoctrinated are most people, including many on the Left, that trade must be 'free' at all costs – which, in practice, benefits the giant transnational corporations at the expense of everyone else. In fact, selecting what to import and how much – which should be the democratic right of all countries – creates the opportunity for economies to develop much faster than otherwise, which would benefit international trade far more than so-called 'free trade'. That is because the faster an economy grows, the more it will need to import (since no country can be self-sufficient), and therefore, the more it will have to export.

Again, China is a good example. Because its economy has been growing so fast – 'in spite of' selecting what it imports – it is enhancing international trade because of its need for raw materials and high technology capital goods. This, of course, benefits the countries exporting those commodities.

People often hark back to the 1930s, when it is said that 'protectionism' caused the worldwide depression. In fact, the cause of the depression was not 'protectionism' as such, but mistaken economic policies (not much different from now) that failed to promote economic growth. Indeed, the main country that carried on providing an extensive market for exports from other countries at that time was also the country that most controlled its imports – namely the USSR, whose economy was expanding rapidly due to its huge industrialisation programme, which is analogous to the position of China today.

To be sure, it would be better if trade policy was decided at international level through the World Trade Organisation. But for this to happen, its members would have to abandon their 'free trade' dogma, and recognise the fact that all countries, in order to optimise economic growth, need to control what they import to a greater or lesser extent – the more so, the less developed are their economies. A system I have proposed is to allow every country an average tariff or equivalent in inverse proportion to its GDP per capita, leaving it up to each country to decide how the tariffs are distributed. Thus, less developed countries would have the higher levels of protection that they need. They would be able to impose relatively high tariffs on luxury imports and products being produced locally for the first time, offset by very low tariffs, or perhaps subsidies, on imported technologies that they need for developing their economies. More developed countries, on the other hand, could use their much lower 'allowances' to limit imports of products tending to undermine employment in certain sectors, giving enterprises the chance to adjust, cut costs, or diversify.

Meanwhile, schemes based on those principles could be negotiated on a bilateral basis. Already, many bilateral trade deals have been agreed, but they need to be made more equitable. At present, many tend to favour the more developed countries, especially the EU and the US, at the expense of less developed countries – which reflects the weaker bargaining positions of less developed countries – so that trade does not grow and benefit the countries concerned as much as it could have done.

The need to raise wages

Once imports are properly planned through selective controls, it becomes possible to introduce many other measures that would benefit manufacturing, and the economy as a whole.

For example, it would be possible to raise substantially the minimum wage – with knock-on effects on wages for more skilled workers – without this having the effect of drawing in more imports at the expense of domestic producers. This would have the effect of boosting economic demand for goods and services, and therefore stimulate investment in their production and supply. Raising wages would, of course, increase costs for employers, but businesses would benefit from the bigger domestic market for their products.

This measure could be backed up by a new Bill of Rights for employees (including repealing the current laws that restrict trade union activities introduced by the Tories in the 1980s, which New Labour had promised but reneged on). This would improve the bargaining positions of workers and their trade unions, and therefore terms and conditions of employment.

Measures to deal with insolvency

Next, new measures could be introduced to deal with the problem of insolvency, through the establishment of an insolvency agency at central and local governmental levels. They could establish a revolving fund, whose function would be to advance low cost loans to help rehabilitate failed businesses – perhaps in a new productive

activity – aimed at maintaining employment and workers’ skills. In many cases, the best option might be to convert the businesses into worker-owned co-operatives. This would have the advantage that the businesses would only have to cover workers’ wages and the costs of inputs, maintenance and marketing, and would not have to generate the high returns demanded by outside shareholders or private capitalists.

Furthermore, new laws could be introduced to require companies to make their accounts more transparent and available to workers and their advisors, giving workers powers to prevent asset stripping, and companies being deliberately run down, thus making insolvency less likely. This would be helped further if the auditing of company accounts became the responsibility of a public agency – perhaps a much expanded National Audit Office (which currently is only responsible for the accounts of central government departments and agencies). This would replace the private accountancy firms that are currently responsible, thus eliminating the conflicts of interest arising from their other role as consultants (a major activity of which is to manipulate company accounts to avoid tax).

Capital controls - and the need to abolish offshore tax havens

Another important measure needed to ensure that the savings and investment resources generated by workers are used for the benefit of Britain’s economy would be to re-introduce capital controls. For these to be effective, all dealings with businesses and subsidiaries based in offshore tax havens would have to be made illegal (preferably through international agreement, with suitable compensation for small island tax havens). It was precisely the mushrooming of offshore finance that did most to undermine the capital controls that were in place more or less everywhere in the 1950s and 1960s. Instead of reining in these activities, governments caved in to the lobbying of the big banks. They allowed these offshore havens to flourish, and eventually deregulated international capital flows almost entirely. As is now evident, this not only greatly benefited the rich at the expense of the poor, thus exacerbating inequalities worldwide (countries and people), but also is what made the current economic crisis far deeper and more destructive than it might have been.

The role of a revamped Department of Trade and Industry

If a government is serious about enhancing the role of manufacturing in a more diversified and re-balanced economy, and optimise economic growth, it will need to re-introduce some form of economic planning. This could be achieved through a re-established and revamped Department of Trade and Industry. Among its tasks would be to:

- Manage trade policy to maximise the benefits of international trade for Britain’s economy;
- Co-ordinate investment in the various sectors of manufacturing, including in the public sector where appropriate;
- Administer taxes and subsidies to favour industries having the greatest impact on economic development and those needed to reduce emissions and other adverse environmental effects;

- Oversee and help fund research and development endeavours carried out by companies, research institutions and universities;
- Introduce a new system of training through the establishment of manufacturers' associations in the different sectors, linked to technical colleges and universities, thus giving workers the theory and skills needed to maximise their contribution to economic development.

Conclusion

Once one abandons the dogmas of privatisation and 'hands-off' government, all of the measures proposed above to revive manufacturing industries, and reduce their environmental impact, are perfectly straightforward and obvious. Why cannot governments see this? Why cannot they see that 'hands off' allows the rich and powerful, the giant transnational corporations and financial institutions, to dictate policies – which, as is now evident, has led to the growing divide between rich and poor, and now, probably, one of the worst economic crises since the start of the industrial revolution, the brunt of which they expect ordinary people to bear. It is surely time to change course. Britain, following in the footsteps of China, could show the way.

Everything must go? Brown's asset sales assessed

Andrew Fisher

Just as Thatcher bagged up the family silver and flogged it at knock-down prices to her mates in the City, so Brown and Darling have scraped around for any valuable bits that Thatcher and Major inexplicably overlooked.

And so on 12th October 2009, Gordon Brown announced what Alistair Darling had already announced in the Budget in April 2009: the great New Labour sale – everything must go! – from the Royal Mint to Royal Mail, the Ordnance Survey, the Channel Tunnel Rail Link and much much more!

The flaw is that many of these government controlled assets are exactly that: assets. They generate income into the Exchequer, and so Brown is – as John McDonnell MP pointed out – “slaughtering geese that lay golden eggs, for a one-day fry-up”.

Table 1 below shows the level of revenue that some of these assets generate to the Exchequer every year. In addition the Student Loan Company received £900m in 2008/09 in student loan repayments (although these should be written off as unjust debts).

Table 1

Organisation	Turnover	Surplus
Ordnance Survey	£117m	£16m (13.7%)
Royal Mint	£159m	£5m (2.9%)
Tote	£2,900m	£156m (5.4%)
Royal Mail	£9,560m	£321m (3.4%)
Dartford Crossing	£23m	£4m (17.7%)
Urenco (1/3 rd UK stake for sale)	£1,130m	£240m (21.2%)

Without even taking into consideration the revenue generated by some of the proposed asset sales (e.g. Channel Tunnel Rail Link, land and council house sales), we can see that these raise around £1.5bn per year for the Exchequer.

It makes no sense to sell these assets. In fact the imperative would be to create more revenue-generating assets for HM Treasury. The state has recently acquired several banks and the profitable East Coast Mainline franchise – all of which, if properly run, should generate substantial revenue to the Exchequer.

Another income generator is council housing which, as Defend Council Housing has shown, has money taken from it every year. This is why the private sector is keen to get its hands on it – and Brown is only too happy to oblige.

Brown's £16bn asset sale announcement on 12th October included the sale of tens of thousands of council homes – which a cynic might suggest undermines his council housing credibility gained at Labour Party conference for promising to build approximately 2,000 council homes over the next few years.

As Jeremy Corbyn MP said: "To sell assets means a loss of already huge public investments and enables the purchaser to fleece the public for decades to come" – which is of course why they are 'assets' and why the private sector wants them.

Brown's asset sales make no economic sense – they will damage the UK exchequer in the medium to long term and result in worse services due to the innate inefficiency of the private sector. Yes you read that right

Private sector – more efficient? No.

This asset sale further exposes to ridicule the rhetoric of private sector efficiency and dynamism. Why not sell state 'burdens' to these entrepreneurial alchemists to turn to profit – using their innate efficiency? Because the dynamism of the 'profit motive' is a myth, as this recession has so clearly demonstrated.

One private train operator was recently quoted in the trade press as saying, "I do find it slightly irritating that we don't operate on a level playing field with [state-owned] European companies . . . you have entities supported by the state in Holland, Germany and France which do not have the same constraints on them of delivering for shareholders in the way we do. I was concerned that the Dutch could be satisfied with a very low return". Still a return you note, but the inefficient distribution of surplus to shareholders is factored out.

In the days following the public sector takeover of the East Coast mainline rail franchise (formerly operated by National Express) it was announced that seat reservation charges would be abolished and an extra £12m invested in station improvements. The Transport Secretary Lord Adonis stated that he expected to "see real improvements in the service and better value for money", and Elaine Holt who now manages the franchise on behalf of the state said, "over time we'll introduce further improvements to the service, the stations and the trains".

This crisis is throwing capitalism into sharp relief – profit is wasteful, and the corporate sector has consumed more state welfare than if the whole country was on the dole. But it's always been obvious, which would provide a better public service – a public sector operator where any surplus is reinvested into service improvements, lowering costs, and raising staff wages; or a private sector operator that must divert a proportion of that surplus to its shareholders?

A similar instance occurred with the nationalisation of Northern Rock. CBI director general Richard Lambert, said: "It is critically important that state ownership of the bank should not be allowed to distort the savings market, through access to government funds on favourable terms". This roughly translates as a publicly-owned bank can offer better terms to savers (aka "distort the savings market" in CBI-speak).

The private sector is terrified of fair competition from the state and non-profit models of production – and this should give us the confidence to argue for and develop the alternatives.

The Cost of Public Sector Cuts

Richard Murphy

There's been a lot of discussion about the need for public sector cuts. Give or take the public sector employs about 5 million people. If there were to be public sector cuts of 10% then maybe 500,000 people would lose their jobs.

I have considered the consequence of this by doing a simple exercise. I have done a case study on the cost of a person earning £25,000 per annum who is a single parent with a child of school age, paying £500 a month in rent and £700 a year in council tax losing their job. The assumptions are slightly simplifying: benefits are harder to calculate in more complicated households. The rate of pay is slightly above mean and significantly above median UK pay. But £25,000 is a good, round number.

The total tax paid and benefits received by this person look like this:

Income		£25,000
Income tax paid		-3,705
National insurance paid		-2,120
Net pay		19,175
Council tax paid		-700
Income after council tax		18,475
Add:	Child benefit	1,040
	Child tax credit	1,110
		2,150
Disposable income pre rent		20,625
Rent paid		-6,000
Disposable income after rent		14,625
Tax (VAT, petrol duty, car tax, TV licence, alcohol duty, etc.) paid out of disposable income (approximately 15%)		2,300
Income tax paid (as above)		3,705
Council Tax		700
National insurance paid (as above)		2,120
Total tax paid		8,825
Add, National insurance paid by employer		2,465
Total tax paid as a result		11,290
Less, benefits received (as above)		2,150
Net contribution to government		£9,140

Now assume the same person was unemployed. They would get the following benefits:

Job seeker's allowance	£3,353
Child tax credits	2,785
Child allowance	1,040
Housing benefit	6,082
Council tax benefit	700
Total income	13,960
Tax paid: council tax	-700
Net income after tax	13,260
Rent paid	-6,000
Net income after rent	7,260
Tax (VAT, petrol duty, car tax, TV licence, alcohol duty, etc.) paid out of disposable income (approximately 15%)	1,100
Add, council tax paid, as above	700
Total tax paid	1,800
Net cost to government	
Total benefits paid	13,960
Less: tax paid	-1,800
Net cost to government	£12,160

The total lost to the government if this person loses their job in the private sector is the addition of the total contribution lost plus the total cost paid. That is £21,300.

It could be argued that the cost is less in the public sector because tax deducted goes straight back to pay the employment cost. It so happens the net effect is the same. In that case the comparison with the private sector is maintained here.

The actual cost is higher though. The person in work has disposable income of about £14,625; the same person unemployed spends £7,260. That is a difference of £7,365. In other words they are twice as well off in work as out of work. But, most importantly, of that difference at least 65%¹ will support other people's wages plus the taxes they spend on goods and services. Assuming these other people pay taxes at about the same overall rate as the person in the above exercise (and this is likely) that means about 36% of that difference will indirectly go in tax as well. That's about £1,700. So now the benefit of keeping the person in work is £23,000 and they are only paid £25,000. Put it another way: 92% of the cost of cutting a £25,000 a year job when we have less than full employment is paid by the state.

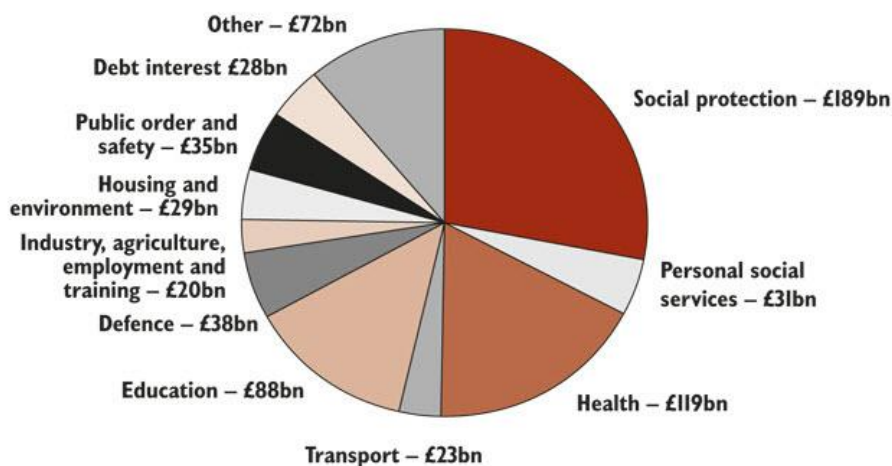
In that case it is abundantly clear that paying to keep people in work pays – especially and even particularly if what they do has long term benefit that saves cost into the future. That cost saving – for instance from green efficiencies – has only to be £2,000 for it to be entirely worthwhile creating a job out of government spending to keep this person in work.

¹ <http://www.statistics.gov.uk/pdfdir/qna0609.pdf> table D using 2008 figures

And that is before any account is taken of the social costs of being in employment, which are substantial in terms of reduced crime, improved educational outcome, better health, and more besides.

Now let's reflect on the fact that in reality the average direct cost of employing an average public sector employee is less than this. Let's make it around £21,000 – more like median pay – and then note that 500,000 at this pay rate will supposedly save £10.5 billion in the wage cost of the government. Putting these half a million people out of work will save us about £0.8 billion. That's misery for 500,000 people and their dependents to save just £1,600 per job lost.

That though is not the end of it. Total government spending is £671 billion, split down like this:



So, to cut spending by 10%, £57 billion of extra cuts are required on top of sacking 500,000 people. These savings would need to be made up of:

1. Reduced benefits, which will result in reduced consumer spending, or
2. Reduced payments to private sector contractors to provide work to the government.

Either way there is reduced demand. £57 billion of reduced demand. Of which 65% approximately will go to labour. That's £37 billion of labour cuts then. At £25,000 or so a head (approximately) that's over 1.5 million more unemployed.

That, with the losses from the public sector adds more than 2 million to unemployment – making well over 4 million in all. Some consider this likely, I know. But what is the effect on public spending? Maybe 92% of the cost of this cost in lost wages will fall on government either by benefits paid or lost revenue. That's £34 billion. And that's before we deal with the massive social and crime related costs of that level of unemployment and the collapse in our long term prospects.

So, to achieve total savings of maybe a net £4 billion in borrowing (£3 billion net from private sector cuts and about £1 billion net from public sector employee cuts) this policy would put 2 million people out of work.

Now I know all the problems of extrapolation in here, and I know that not everyone will get benefits in the way I have outlined above (but those that don't will suffer even more extreme losses in income – compounding losses elsewhere) but frankly all analysis in this area is moving into the unknown, economically and statistically speaking. And losses to government may also be bigger than I suggest – after all out of the £57 billion of non-labour cost cuts required £20 billion will be lost profits and rents – and they could result in £6 billion of additional government tax losses, tipping the equation in the direction of any cuts in government spending creating actual cost for the government.

Which makes clear that the logic of cutting government spending now when we have no jobs for those we make unemployed makes no sense at all. It's profoundly annoying to have to reinvent the whole Keynesian argument in this way – because that is exactly what I am doing – but needs must precisely because so many do not seem to understand this obvious fact.

Of course this situation will eventually change: private sector demand will pick up and employment with it. But right now there is no sign of that and to cut now would, I can confidently predict, produce something like the outcome I predict here. Put simply: cut spending and we'll increase government debt. Perverse you might think – but true, and exactly what Keynes predicted.

What is more, the reverse is true. Increase spending now and the multiplier effect which compounds the impact of cuts in the above analysis goes into reverse: more jobs are created, revenue flows to government, benefit spending falls and government debt goes down with it.

The answer is simple: if we want to get out of the mess we're in we spend. It's the only way to reduce government debt at this stage in the economic cycle. It worked in the 30s. It will work now. Let's do it.

The UK needs Annual Land Value Tax

Dave Wetzel

This last pre-budget statement before next spring's General Election gives the Labour Party an opportunity to set the UK economy and our social relations on a totally different path.

The concept of "annual land value tax" sounds just like another detailed fiddling with tax policy that will have no greater impact on the economy than an extra penny on a pint of beer. But in fact, the introduction of an annual land value tax (LVT) would be truly radical.

Our planet is 4.5 billion years old. For most of the hundred thousand years of humankind's existence on this planet, land has been shared as a common resource like the air we breathe, the wind that turns windmills or the sunshine we rely upon to grow our crops and provide us with energy and good health.

Circa eleven thousand years ago we began to change from hunter/gatherers in the wilderness to adopt nomadic and settled agriculture on community owned land. Five thousand years ago city states began to develop on the basis that the surplus arising from the land (rental values) was used to create new communal infrastructure such as roads, defensive walls, bridges, temples, piped water and irrigation systems etc.

It is only in the past three thousand years that individuals began to seek ownership of the surface of our planet and claim nature's rent as their own.

Most economists ignore the role of land in production arguing that since the industrial revolution, land does not play an important role in the economy. They couldn't be more wrong.

But why emphasise land?

Because we cannot survive on this planet without access to land.

We need land to grow food, for mining, to locate homes, commerce and industrial production. In a modern economy we also require tools and machinery (capital) to create wealth. The major difference between capital and land is that capital is man-made and has a cost of production, whereas land is a free gift of nature with no cost of production. Imagine a modern Robinson Crusoe cast away on his own – he can survive without capital (although he would soon utilise his labour and nature to provide simple tools and perhaps a spear to hunt more effectively) but it would be totally impossible for him to survive without access to land and the benefits of nature.

Today landowners benefit from the provision of public (and private) services. As these services improve, so the rent and value of their land increases – without any effort on their part.

The Jubilee Line Extension of the Underground railway in London cost taxpayers £3.5bn but increased land values in the vicinity of the eleven new stations by £13bn.

Two householders in adjacent houses, earning the same wages would pay the same amount in tax to provide good local public services. The one who owns the freehold land and their home would see their tax investment reimbursed as the value of their property increases but the other who rents their home would receive a higher rent demand from their landlord as the value of their location rises – this cannot be equitable, just or fair!

Tony Benn often reminds us that land privatisation was the first privatisation.

So, how in the next budget, can a Labour Chancellor reverse the effects of recent history and restore the rights of all to share land wealth?

The simplest method would be to assess the annual rental value of all sites, identify their owners and levy a percentage of the value each year – an annual land value tax.

This would be the opposite of Labour's development land taxes that have failed so completely in the past. A one-off tax on development can be easily avoided by not developing whereas an annual tax on the rental value of land cannot be avoided and is therefore very cheap to collect.

The immediate effect of LVT would be to discourage land hoarding and land speculation. The owners of land would be encouraged by the tax to put their land to good use. Brownfield sites and empty buildings would be brought into use. Land would become cheaper to acquire. The cost of social and private housing would reduce. Cheaper land and premises would facilitate new start-up businesses and the expansion of existing ones.

An important effect of LVT would be to make our towns and cities operate more efficiently. Not only does a dense population make more use of public and private services but local authorities would be encouraged to provide better amenities such as parks, sports facilities and nature trails as these increase the land values in the immediate neighbourhood.

The whole economy would benefit. Jobs would be created and poverty alleviated. By making better use of wasted sites and buildings in our towns and cities the demand for urban sprawl would be reduced. This would cut unnecessary commuting and transport costs and assist the battle on climate change by reducing carbon dioxide emissions.

The revenue from LVT could be used to address our budget deficit and to reduce taxes on wages and production.

Just imagine the effect of a 5% vat rate, no council tax, no business rates on buildings, no stamp duty and no income tax for workers earning less than the average wage.

David Cameron would be lost for words!

Of course, as with any tax change there would be losers. We need not shed tears for the Duke of Westminster and his ilk who own swathes of the most valuable urban and rural land, but will need to consider transitional help to protect pensioners and others on low incomes but who own their own homes and those on modest incomes with high mortgage repayments. For example, LVT payments could be deferred or rolled over until the property is disposed of and then the outstanding amount (with modest interest) could then be repaid from the sale price, and/or LVT could be introduced with a tax-free personal allowance similar to the personal allowance for income tax. In this way we could ensure that nobody pays LVT on a principal home worth say less than half a million pounds.

Similarly, small businesses operating at the margin of profitability, could also be given transitional assistance which would be of particular benefit in sustaining those businesses which provide unique local services such as the community baker or the local post office.

Like Denmark, parts of Australia and Hong Kong, Harrisburg, the Capital of Pennsylvania, has a modest land value tax. The effect over thirty years has been startling with reduced unemployment and greater prosperity in the city leading to a lower crime rate.

It is not just land that can provide a communal rental value. Personal number plates for cars should be rented for 20 year periods and not sold outright. Toll roads and car parking fees can collect the economic rent of our highways and car parks. Aircraft at busy airports demand both time and space for the creation of valuable landing slots which should be rented to airlines by the government, and yet even for the new proposed third runway at Heathrow (which I oppose) this Labour Government is suggesting we GIVE these landing slots away instead of collecting this public revenue by auctioning them for 10 year periods. In 2000, Gordon Brown rightly rented the spectrum for 3G mobile phones and his 20 year licences raised £22.4bn at auction. He has endowed his successor with the opportunity to raise a similar amount in ten years time.

A Labour Chancellor, Philip Snowden, introduced a land value tax in his 1931 Budget which was repealed by the Tories before the valuation of the land was completed. Herbert Morrison proposed a Land Value Tax for London in 1938.

Alistair Darling needs to break with post-war tradition instead of rummaging in The Treasury's rusty old toolbox.

As land values reach their nadir in the current land cycle, 2010 would be a propitious time to introduce an Annual Land Value Tax.

- Labour Land Campaign - www.LabourLand.org

It Doesn't Have to be Cuts, There are plenty of Alternatives

John McDonnell MP

The backdrop to the Pre-Budget statement is the potential for the Government's annual deficit, previously estimated at £175 billion, to be on course to balloon up to £190 billion. All three main political parties are committed to reducing and eventually eliminating the deficit. Labour's new Fiscal Responsibility Bill commits the Government to cutting the deficit by 50% in four years, while Cameron is proposing to eliminate the whole deficit in one Parliament. Clegg and Cable are calling from the sidelines for a detailed programme of "savage cuts."

Despite threats to bankers' bonuses and on-and-off calls for a Tobin Tax, none of the main political parties is willing to look at a serious increase in the tax take – either by increasing redistributive taxes or tackling large scale tax evasion and avoidance. Only the Chancellor and the most deluded elements of the Bank of England's Monetary Policy Committee (MPC) believe that significant economic growth will materialise in the next two years to lift tax revenues and ease the deficit. The OECD is predicting no more than 1% to 2% growth up to 2011 – and David Blanchflower, former MPC member, is cautioning about the potential of a double dip recession.

The result is a consensus across all the main parties that demands a cutback in public spending not seen in this country since the 1930s.

To achieve a cut of £190 billion, even if the so-called 'smart government' savings were achievable, a Government would have to cut £30-35bn per year for the five years of that Parliament. This would require a 25% cut in public services. On this scale, the Government would need to make cuts that would include over 7,000 GPs, over 4,000 NHS dentists, over 400 NHS hospitals, over 750 secondary schools, over 100,000 teachers and over 10,000 firefighters. Welfare benefits and pensions would inevitably come under attack, and to secure this level of savings would mean cutting unemployment benefit to £45 per week and for the pension age to increase to 69.

If New Labour refuses to break the cross-party consensus on who is to pay for the economic crisis, we are facing the prospect of a sufficient number of Labour supporters staying at home at the General Election to allow the Tories to slip back into office or at best a hung Parliament based upon a cross party economic deal around public expenditure cuts.

The only hope of mobilising our supporters and Labour retaining office with a workable majority is a demonstrable, radical change in political direction by the Government, carried over into its election manifesto. An alternative programme to set out on a new course would include:

- large scale public service investment;
- ending privatisation;
- rebalancing our economy by creating and protecting jobs with investment in manufacturing;
- increasing the minimum wage, state benefits and pensions;

- building and refurbishing the affordable homes we need to overcome our housing crisis;
- making a real commitment to tackling climate change by adopting the green new deal programme for renewable energy and transport;
- securing a peace dividend by withdrawing from Iraq and Afghanistan and scrapping Trident and ID cards;
- confronting the corporate tax evasion scandals and tax injustices and the waste of public resources on Trident and ID cards.

Even at this late stage, adopting a programme like this – and unashamedly promoting it to the electorate – could save a Labour Government, and the economy, but time is rapidly running out.