AUSTERITY and its ALTERNATIVES

The Lost Decade

Updating Austerity in the United Kingdom

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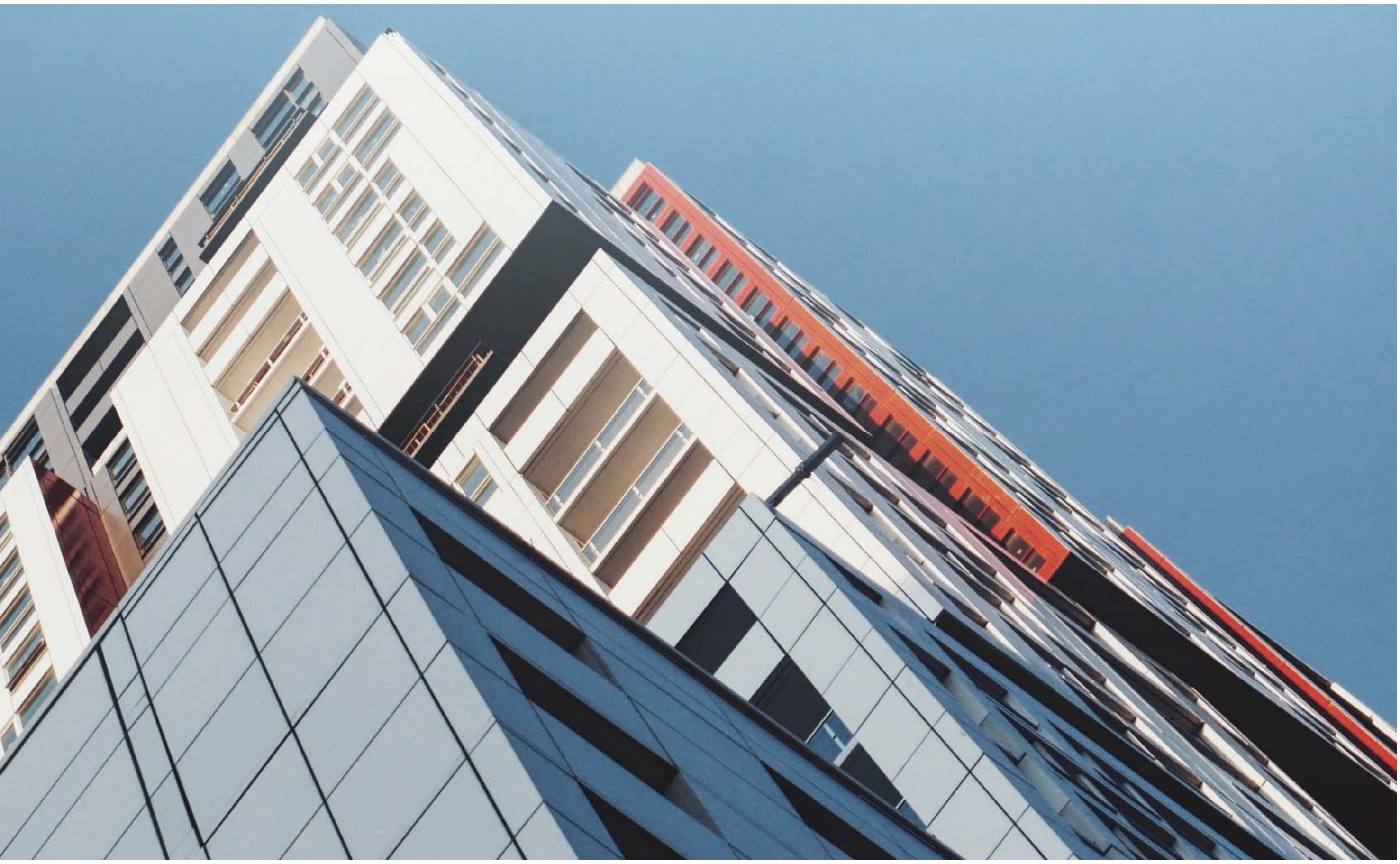

ABOUT US

Austerity and its Alternatives is an international knowledge mobilization project committed to expanding discussions on alternatives to fiscal consolidation and complimentary policies among policy communities and the public. To learn more about our project, please visit www.altausterity.mcmaster.ca.

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Introduction

Superficially, all appears well with the United Kingdom (UK) economy. The International Monetary Fund (IMF) has forecast the UK to be the fastest growing economy among the Group of Seven (G7) major industrialised economies in 2016, with growth of 1.8%, slightly above the G7 average of 1.6%. In the three months to August 2016, there were 31.81 million people in work, including 3.45 million non-UK nationals, or 74.5% of the 16-64 population eligible for employment, the joint highest figure since comparable records began in 1971. Unemployment is 4.9% of the workforce, or technically full employment. In August 2016, 1000 people took strike action, the lowest figure since records began in January 1986.

Despite the uncertainty surrounding the UK's departure from the European Union ('Brexit' hereafter), the economy continues to grow. Gross domestic product (GDP) was estimated to have increased by 0.5% in Quarter 3 (July to September) 2016 compared with growth of 0.7% in Quarter 2 (April to June) 2016. GDP was 2.3% higher in Quarter 3 2016 compared with the same quarter a year ago. Furthermore, Nissan is to build its new Qashqai and X-Trail models at its Sunderland plant, a very welcome boost for manufacturing in the UK.

However, when he became Chancellor of the Exchequer in July, Philip Hammond inherited from George Osborne a fiscal 'mandate' that required the government to balance the books and deliver an absolute budget surplus in 2019-20, with a secondary rule requiring the stock of UK public debt relative to the size of the economy to fall in every year up to that point. Almost immediately, the think tank the Resolution Foundation claimed the new Chancellor would have to respond to an £84 billion deterioration (in 2015-16 prices) in the UK public finances cumulatively across the five years of the forecast period to 2020-21. Leaked documents from the Treasury suggest there may be a £16 billion 'blackhole' in public finances in 2016-2017, meaning that borrowing may not hit the Government's target of £55 billion. In another leaked paper, the Treasury has estimated that a 'hard Brexit' UK exit from the European Union (EU) after 15 years could cost the UK between 5.4 and 9.5 per cent of its GDP, and reduce government tax revenues by between £38bn and £66bn.

In this short briefing paper, I have set out some of the recent developments in policy to update the content of what was included in my chapter submitted for the forthcoming Austerity and The State book edited by Stephen McBride and Bryan Evans. I have addressed the period since the May 2015 General Election which includes the 23 June EU referendum, and David Cameron's replacement as Prime Minister by Theresa May. I will provide a fully referenced and expanded version of this paper during my research sabbatical which commences in February 2017.

The Coalition's Legacy for Austerity

In his June 2010 Budget, George Osborne had forecast public sector net borrowing would decline to 1.1 per cent of GDP in 2015-16; that the structural current deficit would be eliminated by 2014-15, with a projected surplus of 0.8 per cent of GDP in 2015-16; and public sector net debt would peak at 70.3 per cent of GDP in 2013-14, before declining to 67.4 per cent of GDP in 2015-16. Osborne had promised that he would borrow no more than £451 billon during the lifetime of the Parliament, and deliver a national debt of £1284 billion or 67.4 % of GDP by the end of the lifetime of the Parliament.

Under the Cameron-Clegg Coalition, from May 2010 to May 2015, the annual UK budget deficit was actually cut from the inherited £154.9 billion or 10.1% of GDP in 2009-10 to £90 billion or 5.2% of GDP at the end of March 2015. Austerity added £535.8 billion to the UK national debt as its rose from £1012.8 billion or 64.8% of GDP at the end of April 2010 to £1548.6 billion or 83.2% of GDP at the end of April 2015. During the previous Brown Government, which presided over the 2007-2008 financial crisis, a total of £472.7 billion was added to UK public sector net debt.

Since May 2010, there is little evidence of any 're-balancing' away from financial services, and an economy driven by the services sector of London and the South-East, towards manufacturing, exports, private business investment, and the economies of the North of England. In those regards, austerity, in its own terms, has failed to meet its principal twin objectives of eliminating the annual current budget deficit, and re-balancing the UK economy. In the process of expansionary fiscal consolidation ('austerity') has added significantly to public and private indebtedness.

Furthermore, in every year since 2010, the UK has continued to run parallel trade and current account deficits. In 2015, the UK's current account deficit was £100.3 billion or 5.4% of GDP, while its trade deficit alone was £38.57 billion, the outcome of a deficit of £126.3 billion in trade in manufactures and a surplus of £87.76 billion in trade in services.

Therefore, austerity has failed to reverse much longer term trends in the political economy of the UK. It has recorded an annual current account deficit in every year since 1984, reaching a high of £24.7 billion or 4.7% of GDP in 1989. The current account deficit narrowed to a low of £1.3 billion in 1997 or 0.1% of GDP, but between 1998 and 2008, it widened sharply, peaking at £56.4 billion in 2008. The UK has recorded an annual trade deficit in goods in every year since 1983, and an annual trade surplus in services in every year since 1966.

From the 2015 Election to The Resignation of David Cameron

Since the May 2015 General Election there has been a major shift in policy towards austerity. Initially, in its post-election 8 July 2015 Budget, the Cameron Government indicated that its plan was to achieve an annual budget surplus of 10.0 billion in 2019-20, followed by a surplus of £11.6 billion in 2020-21. The plan was for public debt to fall as a share of national income in every year of the Cameron Government, from 80.3% in 2015-16, to 79.1% in 2016-17, then to 77.2% in 2017-18, 74.7% in 2018-19, and 71.5% in 2019-20, before falling again to 68.5% in 2020-21. In a typically bullish Budget statement, George Osborne asserted:

> 'having come this far, there can be no turning back. We should aim for a new settlement across the political spectrum where it is accepted that: without sound public finances there is no economic security for working people, that those who suffer when governments run unsustainable deficits are not the richest but the poorest, and therefore in normal economic times governments should run an overall budget surplus, so our country is better prepared for whatever storms lie ahead. In short we should always fix the roof while the sun is shining'.

In his 25 November 2015 Spending Review, Osborne reaffirmed his commitment to eliminate the budget deficit, and to run an annual budget surplus in 2019-20. The pace of austerity in government spending would decelerate. Osborne claimed 'Over this Spending Review the day–to-day spending of government departments is set to fall by an average of 0.8% a year in real terms. That compares to an average fall of 2% over the last five years'.

The independent OBR estimated that, in aggregate over the full five years, the measures announced in the 8 July 2015 Budget and 25 November 2015 Spending Review would increase real departmental spending (RDEL) spending by £129 billion and deliver £36 billion of tax cuts. This would be paid for by £91billion of tax increases, £43 billion of welfare cuts, £19 billion of indirect revenue and spending effects and £21 billion more borrowing. RDEL spending would be cut by £10.4 billion in real terms by 2019-20.

The measures announced by Osborne in the 2015 Spending Review amounted to a considerable softening of planned austerity in public finances, compared to what had been set out in the March 2015 pre-election and July post-election Budget statements. Indeed, the planned cuts would now be 40 per cent less than the £17.9 billion cut in RDEL spending by pencilled in by the Government in July 2015, and only around a quarter of the £41.9 billion peak cut pencilled in by the Coalition in March (which was then to be delivered a year earlier in 2018- 19).

In contrast to March and July, the Government was no longer assuming that, once the budget had moved into surplus, the real cut to spending would shift significantly into reverse. On the contrary, RDEL spending was now expected to fall appreciably less quickly in real terms over the current Parliament than during the last – by an average of 1.1 per cent a year, compared to 1.6 per cent a year.

In his analysis of Osborne's spending plans, Paul Johnson, the director of the Institute for Fiscal Studies (IFS), the UK's leading independent fiscal policy think tank, noted that between July 2015 and November 2015, the planned average cuts to the resource spending of "unprotected" government departmental spending, (i.e. day-to-day spending other than that on health, schools, overseas aid and defence which was explicitly protected) had been cut from 27% to 18%, but Osborne had left his planned annual current budget surplus for 2019-20. For Johnson, this meant:

'The first thing to say is that this is not the end of "austerity". This spending review is still one of the tightest in post war history. Total managed expenditure is due to fall from 40.9% of national income in 2014-15 to 36.5% in 2019-20. A swathe of departments will see real terms cuts'.

In his final Budget statement on the 18 March 2016, Osborne announced that in the future, UK public debt would now to 77.2% of GDP in 2019-20, when the UK would run an annual budget surplus of £10.4 billion, followed by a further surplus of £11.0 billion the year after.

The Impact of The May Government

Since the 23 June 2016, when the UK voted by a narrow majority (51.9% to 48.1%) to leave the European Union, there have been several important developments in the politics of austerity. First, David Cameron has resigned as Prime Minister and George Osborne has been replaced as Chancellor of the Exchequer by Philip Hammond. Second, before he departed (there is some dispute over whether he resigned or was sacked), Osborne had abandoned his target to achieve an annual current budget surplus, following the lead of his new Prime Minister-but Osborne's change of policy was not sufficient to save his job or political career (at least in the short term). In the November 2016 Autumn Statement, Hammond has confirmed the current budget is unlikely to be balanced, if at all, until some juncture during the next Parliament, and then only if there is further austerity, i.e. fiscal consolidation via further spending cuts.

Third, Hammond has abandoned Osborne's previous fiscal rules, which he was forecast by the OBR to break in every year of the current Parliament. Instead, Hammond has published a new draft Charter for Budget Responsibility, with three new fiscal rules of his own. First, the public finances should be returned to balance as early as possible in the next Parliament (i.e. after May 2020), and, in the interim, cyclically-adjusted borrowing should be below 2% by the end of the current Parliament. Second, that public sector net debt as a share of GDP must be falling by the end of the current Parliament. Third, that welfare spending must be within a cap, set by the government and monitored by the OBR. The great advantage of these new laxer, less demanding fiscal rules is that whether the May Government has adhered to these rules cannot be judged until after the 2020 General Election.

In the face of the uncertainty caused by the UK's proposed departure from the European Union, the May Government is now planning to borrow more-much more, £122.2 billion in total-around half of which has been attributed to the consequences of Brexit for economic performance and public finance. The OBR now forecasts that, in cash terms, borrowing will be £68.2 billion in 2016-17, falling to £21.9 billion in 2019-20-a figure which is £32 billion higher than planned by George Osborne as recently as his March 2016 Budget.

Over the last 6 years the annual current budget deficit has been cut by almost two-thirds from its 2009-10 post-war peak of 10.1% of GDP to 4.0% in 2015-16. The independent Office for Budget Responsibility (OBR)'s forecast shows that the public finances will no longer reach a surplus by 2019-20. Public sector net borrowing (PSNB) is higher than forecast at Budget 2016 in every year of the current Parliament, higher by £32 billion in 2020-21, while Public sector net debt (PSND) is now forecast to peak at 90.2% of GDP in 2017-18, before falling back in 2021-22 to 81.6% of GDP (compared to the 64.8% of GDP in April 2010 inherited by the Coalition government). In June 2010, it was forecast to peak at 70.3% of GDP in 2013-14.

By the end of March 2020, the forecast is for UK Public Sector Net Debt to be £1945 billion of 88.0 per cent of GDP. In ten years, austerity will have added £932.2 billion to the UK national debt, or an annual average of more than £93 billion.

In summary, the consequences of the policy decisions taken since March 2016, not least to take into account the detrimental impact of Brexit on UK economic performance and living standards (at least in the short term), is that Philip Hammond has chosen to borrow £122.2 billion more by 2020-21, compared with Osborne's March 2016 plans. Furthermore, Hammond is predicting that by the end of 2019-20, the UK's net public sector debt will be £1945 billion, a staggering £220 billion more than Osborne's March 2016 forecast of £1745 billion. Brexit will pile more public debt on to that added as a consequence of the pursuit of expansionary fiscal consolidation. The IFS has further noted that the OBR's forecast impact of Brexit upon the UK's public finances is to add £15.2 billion to borrowing in 2019-20 (£290 million per week).

Brexit will be expensive for UK taxpayers. Since the annual current budget deficit is now also forecast to be 0.7% of GDP in 2021-22, the IFS has concluded that further austerity is likely needed thereafter to deliver an overall budget surplus. This further austerity could amount to 1.5% of national income (equivalent to £30 billion in today's terms), which might be – achieved by a two year real freeze to total public spending. In effect, the May Government's fiscal policy choices, coupled with the impact of Brexit, are adding further years to the UK's decade of austerity. What was once planned to take a single, five year parliamentary term to balance the UK current budget may not now be accomplished before the end of three, five year terms of office.

The Lost Decade: The Impact of Austerity on Living Standards

The most distinctive feature about the current decade of planned austerity via fiscal consolidation in the UK is its impact upon real average living standards. Paul Johnson from the IFS has noted how the outlook for UK living standards has deteriorated 'rather sharply' since Osborne's final March 2016 Budget, i.e. before the 23 June Brexit referendum outcome. Indeed, Johnson has further observed that the OBR forecast now sees real average earnings in the UK rising by less than 5% between November 2016 and 2021, making them 3.7% lower in 2021 than was forecast in the March 2016 Budget. In short:

> 'real wages will, remarkably, still be below their 2008 levels in 2021. One cannot stress enough how dreadful that is – more than a decade without real earnings growth. We have certainly not seen a period remotely like it in the last 70 years.'

Brexit will also reduce forecast UK living standards. National income (measured as real GDP) is now predicted to be £30 billion or 1.2% lower in 2020-21 than forecast in March 2016. The IFS has calculated that it will amount to an annual average loss per household of £1250 in 2020-21.

Even the Governor of the Bank of England has acknowledged the scale of the impact upon living standards. Mark Carney has warned of 'the spectre of monetarism' in a speech where he spoke of 'the first lost decade since the 1860s' because 'Over the past decade real earnings have grown at the slowest rate since the mid-19th Century' (Carney, 2016). All in all, the true scale of the damage which the politics of austerity has inflicted upon the UK economy since May 2010 is now becoming ever more apparent even before the May Government triggers the Article 50 negotiations that will lead to the UK's departure from the EU.

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