



fight the cuts

Countering the cuts myths

The government and the press say we are in the grip of a debt crisis caused by the 'bloated' public sector. Here, *Red Pepper* debunks the myths used to push cuts to jobs and public services

MYTH Government debt is the highest it's ever been

The UK's government debt is at around 70 per cent of GDP (the total amount of goods and services produced in one year). That is certainly high, but it is far from unprecedented.

Government debt never fell below 100 per cent of GDP between 1920 and 1960. It is only in the past decade or so that it has become normal to think of government debt being stable at around 40 per cent of GDP.

It is worth noting that government debt reached 250 per cent of GDP around the end of the second world war, as the result of a 'once in a generation' economic and political crisis. It is certainly arguable that we are now living through a similarly momentous crisis.

MYTH The UK's debt crisis is one of the worst in the world

Just as the current level of government debt is not unprecedented historically, neither is it substantially higher than that of other countries.

IMF data (*IMF World Economic Outlook Database*, April 2010) shows the UK has the lowest government debt as a proportion of GDP among the G7 countries (the US, Canada, Germany, Britain, Japan, Italy and France).

Much has been made by Cameron and Osborne of Gordon Brown's 'imprudent borrowing record'. They say that before the spending to stabilise the financial system, public debt was high.

But again, IMF comparisons of the level of public debt prior to 2007 showed the UK in a much better position than many comparable countries, such as France, Canada, the US and even Germany, the home of fiscal rectitude.

MYTH Government debt is 'unsustainable'

The sustainability of government debt is not just dictated by its size, but by its make up. We have already seen that government debt is at a comparable level to other similarly sized economies. Where the UK is in a much stronger position, however, is in the nature of its debt.

While countries such as Greece tend to owe money to external financiers, the vast majority of UK debt – about 70 to 80 per cent – is held within the country.

And the UK's debt is not so short term. Countries such as Greece, Ireland and Portugal have average debt maturity rates of between six to eight years, but UK government debt stands out among international comparisons as being much longer term at well over 12 years on average.

This means that the UK has to ask the financial markets to refinance its debts much less frequently, making it less vulnerable to short-term speculative pressures and much more able to continue to finance its debts on a sustainable basis.

MYTH The government shouldn't get into debt, just as your own household shouldn't

This overlooks the fact that, for the past 30 years, governments have positively encouraged households to get into debt.

In fact, it can be prudent for households to take on debt – particularly if they are borrowing to pay for something (a house or educational qualification) that might reasonably be expected to improve the household's income and well being in the long run.

In just the same way it is often sensible for governments to take on debt to pay for investments (such as housing or transport infrastructure) that will make the economy work better and so pay for themselves over the longer term.

But the public economy is also different from the household economy. What might make sense for a household could, for the government, deepen a recession. When times are hard households tend to tighten their belts – reducing their spending and borrowing. But if everyone does this at the same time, the effect is counterproductive: total demand for goods and services falls, which makes it harder for businesses and individuals to generate an income, and everyone ends up worse off.

This is exactly what is happening now, which is why it is essential for the government to compensate for households' reluctance to spend and invest.

MYTH Public spending got 'out of control' under Labour

It is true that the Labour government gradually raised public spending in the early part of the decade, but it was from what were historically very low levels.

Levels of public spending are now about the same as they were in the early 1990s, at the time of the last economic crisis. This is because spending always rises during a recession as a result of welfare spending on unemployment.

In fact, levels of public spending as a proportion of GDP were much lower for most of the 2000s than they were than at any point since the 1960s.

Where Labour did spend more in the years after 2000, it was necessary to repair the visible effects of long-term under-investment. Who can forget schools and hospitals with buckets in the corner to catch the leaks, or grim city centre landscapes with crowds of homeless people sleeping rough?

Labour's increased spending also addressed workforce shortages in schools and the NHS, where more staff were needed to raise educational standards and care for an ageing population.

Rather than cutting such spending, the crisis could be an opportunity to build the infrastructure of a more energy-efficient, green economy. That would prepare us for the longer-term

structural barriers to growth presented by climate change and the depletion of natural resources.

MYTH The UK has a big public sector compared to other countries

Public spending in the UK is lower as a proportion of the economy than in the likes of France, Italy, Austria and Belgium, as well as the Scandinavian countries (*OECD World Factbook 2010*).

And spending on core areas such as health and education remains comparable or low in relation to other OECD (broadly speaking, 'rich') countries.

For example, the UK spent just 8.4 per cent of its GDP on health in 2007, roughly half that spent in the United States (once the large private sector is taken into account) and well behind Germany, France and most other west European nations.

On education, the UK again spends less per pupil than most comparable OECD countries.

The UK is not profligate in public spending and does not have an oversized public sector compared to similar countries.

After the last crisis of this scale, when public debt was something like three and a half times the size it is today, we created the welfare state

MYTH Spending on the public sector is 'crowding out' private sector growth

It is argued that public spending comes at the expense of overall growth, because potential investment is being re-directed into taxation to fund an 'unproductive' public sector. But in fact





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investment in public infrastructure and services is essential to private sector productivity, and so is no less critical to future growth than private sector investment.

Furthermore, the UK is not a highly taxed economy. The OECD's comparative figures on taxation as a proportion of overall economic output show the UK way down the list, only just above the average.

It is sometimes suggested that taxes hit the private sector in such a way as to discourage job growth. Again, though, the data shows the UK to have very low levels of taxation per job: far lower than the OECD average.

The second way in which the public sector might be said to be crowding out private sector growth is by taking workers it needs, but this would only really be the case where the labour market was operating close to full employment.

With the unemployment rate at about 8 per cent, this is clearly not the case, and in many areas of public provision – from child protection, to education and training, to care for the elderly – there is a pressing need for more, not fewer, public service workers.

Finally, some argue that public investment 'crowds out' private investment, because government borrowing pushes up interest rates and inflation. But there is no evidence that this is currently a problem – real interest rates are low, and the economy is still operating well below its potential output, which means there is lots of room for non-inflationary public sector expansion.

In fact, in current circumstances, public spending is more likely to stimulate private sector investment by maintaining levels of demand and preventing a deeper collapse of economic activity.

MYTH Public sector workers are overpaid

It is true that very recently average wages in the public sector have moved marginally above those in the private sector. This is mainly because privatisation has pushed many low-paid jobs out to the private sector.

The trend is not that public sector wages have risen sharply, but that private sector wages have fallen – a characteristic of the economic crisis. If we take a longer view, since the 1990s average public sector pay has not seen significantly more growth than the public sector.

And when private sector wages are split up to consider different sector and occupational patterns, a rather different picture emerges. Wage rates differ widely, with the average pulled down by very low wage sectors such as distribution, retail and hospitality.

What the data shows, therefore, is not that public sector workers are overpaid, but that some private sector workers are severely underpaid.

MYTH The financial crisis was caused by a lack of money in circulation

This one is true to some extent, but it requires careful explanation. The system of finance capitalism pursued in the UK and US since the 1970s has continuously recycled economic surpluses away from the poor toward the rich. In both countries, the share of economic

output taken up by wages (as opposed to profit) has fallen, and inequality has risen. The very affluent have got wealthier, at the expense of the rest of the population. In 2007/08 the richest tenth of the population had more than 30 per cent of total income ('Income Inequalities', poverty.org.uk).

In the post-war period, part of the role of the state was to redistribute economic surpluses to the wider population so that they could keep spending on goods and services. This was seen as so important precisely because large inequalities had been identified as one cause of the 1929 stock market crash and the subsequent depression.

For a while, the problem that rising inequality presented for growth was overcome by the use of credit and the super-exploitation of workers in the developing world, which allowed consumers to keep buying cheap products. This is one of the factors that fed the debt crisis.

So, yes, there is not enough money in circulation – but this is precisely because it has been captured by the super-rich.

MYTH Cutting public spending will help us avoid economic disaster

A range of economists, from Larry Elliott of the *Guardian* to Nobel prize winning professors like Paul Krugman and

Joseph Stiglitz, are warning that making cuts now raises the very real possibility of undermining the fragile economic recovery.

As every first year economics student knows, there are four main components of economic growth: (1) exports; (2) investment; (3) household spending; and (4) government spending.

Over the past two years, governments around the world have stepped in to bridge the gap in the first three by providing debt-financed public sector stimulus packages. There is precious little evidence that the private

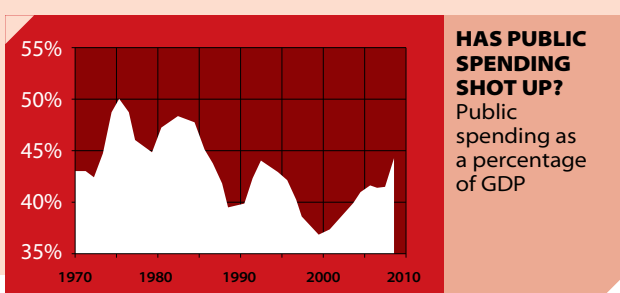
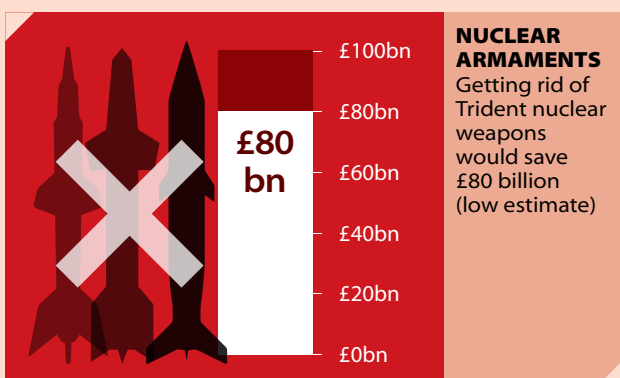
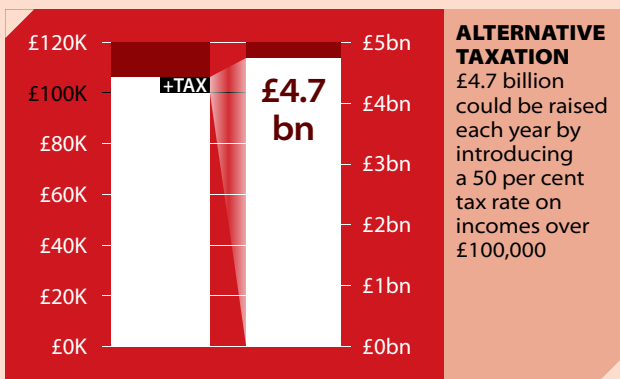
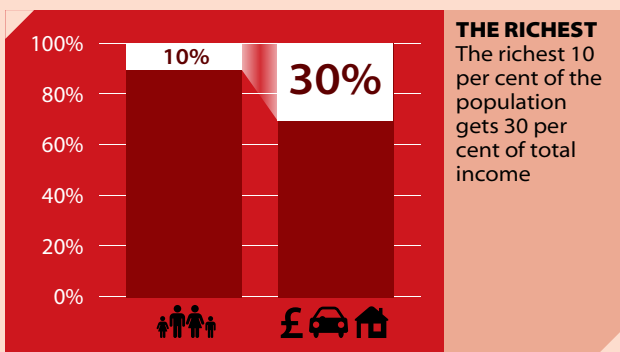
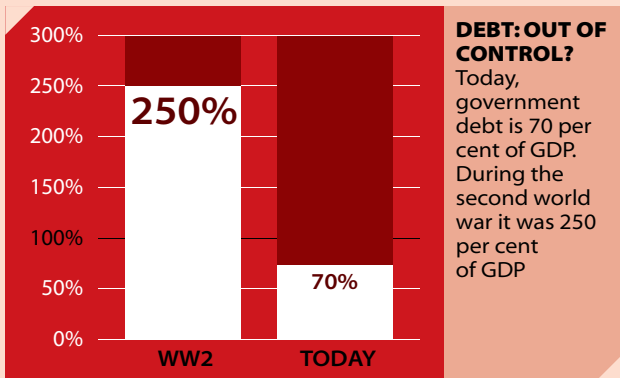
sector or households are ready or able to step up their activity to fill the gap, or that exports will increase in a world where our major trading partners are also reining in spending.

As such, any austerity programme may prematurely remove the foundations of the recovery and lead to a return to recession – a 'double dip'. This would be disastrous, not just for growth, but in turn for tax receipts and the capacity of the state to reduce the deficit and government debt.

How will that help to stabilise the world economy? How will it deal with the frequent, persistent and cumulative financial crises that are endemic to it, or overcome the pressing resource and environmental constraints that are so clear for all to see?

The economic crisis was a golden opportunity to move toward a more economically, socially and environmentally sustainable national and international economic system. For a while all countries were so concerned about the whole system

Increases in spending were necessary after long-term under-investment. Who can forget schools and hospitals with buckets in the corner to catch the leaks?



that there was at least a chance to overcome narrow self-interest and look toward a more co-operative and sustainable future.

We are about to squander a once-in-a-generation opportunity for progressive change – unless, that is, we organise and campaign for an alternative.

MYTH There is no alternative to cuts

The beginnings of an alternative have already been discussed. For example, Unison's alternative budget ('We can afford a fairer society', *Unison Alternative Budget 2010*) suggests that almost £4.7 billion could be raised each year from introducing a 50 per cent tax rate on incomes over £100,000.

About £5 billion could be raised every year from a tax on vacant housing; £25 billion a year could be raised by closing tax loopholes; and the IPPR think-tank has estimated that a 'Robin Hood tax' on financial transactions could raise another £20 billion a year (T Dolphin, *Financial Sector Taxes*, IPPR 2010).

All these taxation measures would be 'progressive' in the sense that they would divert wealth from the rich to the poor, in contrast to measures such as the government's VAT increase, which hits the poor hardest.

In addition, some of these ideas might have behavioural advantages: they could work against destabilising speculative financial flows, or lead to fewer empty houses.

Similarly, we could look at spending that really should be cut. For example, while estimates of the true costs of replacing the Trident nuclear weapon system vary widely, they tend always to come in above £80 billion over 25 years.

Getting rid of the cost of the war in Afghanistan, massive consultancy fees on private finance deals and contractors' profits in privatised public services would also make a difference.

We could also decide to manage the deficit and public spending in a long-term manner, targeting social issues such as inequality, under-investment in education and child poverty, and strongly regulating international financiers, banks, hedge funds and the like.

All of these are political choices.

We don't have to live in a world where unemployment co-exists with a long-hours culture in which workers are so stressed that mental health problems are on the rise.

We don't have to live in a world where bankers gamble millions across the world in elaborate financial casinos at the same time as 1.4 billion people live on less than \$1.25 a day.

We don't have to live in a world where there is no limit to how much of our collective economic output goes to the rich, yet others do not have enough to eat.

It is worth remembering that after the last crisis of this scale and significance, and with public debt something like three and a half times the size it is today, we established the NHS, created the welfare state, put in place comprehensive education and built a vast number of public housing estates.

History tells us that there is more than one way out of an economic crisis. ■

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www.alexnunn.net csetranspennine.wordpress.com

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