The ‘emergency’ budget – solving the UK’s problems? Or creating the basis for new crises?

This week’s budget saw the introduction of massive cuts to public sector spending, benefit reductions, lowering of corporation taxes and a rise in VAT. Five LSE experts discuss its key implications:

> ***Is this a progressive budget?***
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> *The tax side of the budget is carefully done, but it can only work as the government intends on average, says **Professor John Hills**. Some large groups of low income citizens in particular circumstances will certainly lose out. And the spending cuts must end up doing most harm to the poorest groups.*
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> *The tax changes, and the changes to some of the tax credits, which were presented on Tuesday, are very carefully balanced. The analysis the Treasury have done suggests they take roughly one percent of the income out of all income groups, a little bit more at the top, and actually a little bit more for the bottom group. At each place where something hits the poorest a bit harder, there’s some compensation, the increase in the income tax allowance for instance, or the extra £150 in the child tax credit. So, looking at that part of it, it does look as if everybody is putting in the same share of their income.*
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> *But that’s only a small part of the picture. First, some of the things that produce the fairly even sacrifices across the income scale result from measures raising tax for those on high incomes that were announced by the old government back in the March Budget – without those, the extra measures announced on Tuesday would look regressive, not progressive.*
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> *Second, we need to remember what happened when the last government abolished the 10 pence income tax band in April 2008. On average the changes coming in then were progressive – better for those on lower incomes. But that average disguised some groups with low incomes that were substantial losers – for instance those who were not entitled to tax credits, or failed to claim them. It was when that became apparent that the row broke out. The same issue of variation around the average will apply this time round too.*
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> *But the biggest point is that one of the first things that the Chancellor said, was that he’s looking to get 77 per cent of the deficit reduction out of spending cuts. It’s very hard to do that kind of level of spending cuts without hitting the bottom half of the population much harder than people near the top, because public spending is much more important to people in the bottom half of the population. If you take the big picture, over the long term, and take the fact that the Chancellor announced another £30 billion of spending cuts, over the next four years, the people who are going to lose out most from that, in relation to their income, are those on lower incomes, not those on higher incomes, and that certainly cannot be described as ‘progressive’.*

> ***Will the new policy machinery fix longer term budgeting imbalance problems?***
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> ***Joachim Wehner*** *sees progress, but thinks there may be more distance yet to go.*
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> *George Osborne announced a new “fiscal mandate”: the structural current deficit should be in balance and debt as a share of GDP falling by 2015-16. The Office for Budget Responsibility will assess the output gap, providing a safeguard against political manipulation. Although some take the view that this goes too far too quickly, the inconvenient truth is that stabilisation is only the first step in what must be a more fundamental rethink*

of the country's fiscal framework, one that addresses the budgetary pressures arising from an aging population and ensures Britain is better prepared for the next big crisis.

Many other countries have recognised that their ability to respond to economic shocks requires fiscal discipline in the good times. In Sweden, the government earlier this year announced plans to enshrine its surplus target in legislation. In Germany and Switzerland, constitutional "debt brakes" have been introduced to enforce balanced budgets. Some of these initiatives are controversial, but they signal a wider and long-term debate about fiscal sustainability and inter-generational fairness that Britain, too, will have to confront. For now, with total consolidation of £113 billion and only about a quarter of that financed with tax increases, the scene is set for a dramatic multi-year spending settlement in the autumn. Expect more intense and robust parliamentary discussions than seen for many years.

A probable recipe for a public services crisis in 2 to 3 years

*Some of the implied spending programme cuts are not achievable, believes **Patrick Dunleavy**. And the public sector pay freeze dangerously links inflation and likely levels of industrial militancy.*

The rhetoric of an 'emergency budget' may get the government through the next six months politically (just until the VAT rise kicks in), but the budget is storing up problems for the future. First, the implied programme cuts of 25 to 30 per cent in some non-protected areas of domestic spending (like the law and order budget) are neither desirable nor achievable. The political will to make them is consequently likely to unwind long before the end of this Parliament. Unless whole areas of government activity are terminated completely, or more state assets are sold, the budget numbers propped up by this level of cuts should not be believed by voters or markets. Twenty per cent cuts are achievable over four years in many spending areas, and perhaps somewhat more in welfare programmes. But higher levels are fantasy options.

Second, most of the government's ideas for achieving spending reductions all show a distressing short-termism at present and an absence of long-run strategy. Squeezing IT suppliers and scrapping consultancy contracts is good news in terms of money saved for a year or two at most. But to save money long term, what we desperately need to do is to develop in the public sector the capacity for savings from digital disintermediation processes that has revolutionized many private industries already, and will work through most of the others in the next decade. You cannot do this change by having less effort on government IT, less organizational innovation and fewer new developments than in the past. Two years from now the danger is that the whole government sector will be unmodernized, more out of date and more living in a labour-intensive, paper-processes past than it already is now, while its innovation programmes and capacities will have dwindled away.

The two year pay freeze for all but the lowest paid public sector workers is a third policy that looks unsustainable. It creates a huge incentive for the 20 per cent of public service staffs who are the most enterprising and effective (and who hence get 80 per cent of the work done) to up sticks and leave, unless the rest of the economy is so flat on its back that exit is impossible. Skills gaps in government will grow up in lots of little pockets as good people leave and cannot be replaced, worsening the overall effectiveness of the whole apparatus. The government has taken an axe to regulatory and target-setting standards partly in anticipation of this decline. But legal cases and public protests about worsening services will likely peak in early 2012, creating pressures on ministers to re-intervene in top-down ways.

Fourth, at just the same time, industrial militancy in the state sector is likely to reach boiling point. The government will cut most state workers' wages by 5 to 6 cent through inflation by then, and the budget has added the VAT increase of 2.5 per cent as well. By then also, the burden of cutbacks will mean a public sector workforce that is being coerced to do more with less, whose labour productivity will have been pushed to unsustainable heights by short-termist squeezes. All this will have occurred without a long-run vision that holds out much hope to state workers of any easing of future pain or the maintenance of effective services (even in the NHS, service declines will be evident by then).

Fifth, the pay freeze means that the government has linked the development of this scenario to the least successful aspect of economic policy in recent years, namely the management of inflation. If the Bank of England could ever consistently hit its 2 per cent inflation target, state sector workers might just hold off in 2012 and push instead for a big catch-up pay deal in 2013, (which the government will sooner or later have to concede for the efficiency reasons above). But if the Bank continues to be unable to curb rises in the costs of living, or if there are external inflation shocks, then 2012-3 could be crunch time for the government's strategy.

The Smaller Society

*The budget heralds an effort at remaking British society in non-statist ways that **Bart Cammaerts** believes is unlikely to fill the gap left by cutbacks*

During the recent campaign the Tory party foregrounded the concept of the Big Society. Appropriating Etzioni's normative conception of citizenship as being not only comprised of rights, but as much of responsibilities, the Big Society implies more individual and community responsibility coupled with less state and government intervention – the Dunkirk spirit for a time of peaceful despair. In this way citizens would supposedly get more for less and after the budget was announced it appears that it is much less. However, will a serious reduction in state financed services, more unemployment and less disposable income for working singles and families bring us ultimately more, will it lead to the emergence of the so-called Big Society?

Contrary to what was claimed during the campaign and despite the appropriation of the discourse of progressiveness by the Lib-Tory coalition, not much has changed ideologically. Liberals and conservative typicallyconstruct a dichtotomy between (civil) society and individual citizens on the one hand and the state on the other. Because of this juxtaposition, a bigger society inevitably means a smaller state. Hence, the outsourcing or the delegating of as many tasks as possible from the state to civil society and to the individual; think of parents running schools, charities helping the poor, citizens patrolling their streets, children caring for their aging parents, students paying for their own education or individual donations financing aid and development.

Image Credit: The Prime Minister's Office

While the state and the taxpayer was very much needed when the financial system nearly collapsed, the same elusive 'markets' are now being used to justify not only a mainly regressive tax-rise, but above all the realization of a long cherished neo-liberal dream – the minimal state. Even Thatcher was never able to slash most departments by 25% across the board. The stakes are high, we are told, and the markets demand a determined and unequivocal response from governments to cut their spending in order to be able to underwrite and guarantee the debts that were made to save 'the market' from complete mayhem. Quite astonishing how quickly this detail tends to be forgotten in the current debate. All too easily the blame is left at the doorstep of the previous government, while in fact all governments of Western democracies are struggling and deciding how deep to cut and in what time-frame. These choices are ideological and need to be exposed as such.

Despite the romantic discourse of the Big Society, the state and its funding plays a critical role in supporting, shaping and sustaining society; by educating children and adults, by getting people out of poverty through specialized help, by providing safety on the streets, by promoting social cohesion through community support and cultural activities and so on. Cutting or reducing these services or funding opportunities, while at the same time risking massive unemployment, will not lead to a Big Society, but to a smaller and more unfair society. Unless, of course, the Government expects all these newly unemployed to come and work for them as volunteers to provide the services they used to be paid for properly in return for their *benefits.*

The budget's impact on regional economies – can it help economic revival?

*asks **[Tim Leunig]***

By definition, a budget that cuts will hit areas outside the South East hardest, since the public sector makes up a bigger proportion of the economy in areas in which the private sector has been weak for many years. In that sense this budget – and the cuts to come – will hit poorer areas hardest. It is not credible to claim that cutting the public sector in places like Stoke and Hull will lead to a renaissance of the private sector. Cities such as these already have high rates of unemployment, people wanting to be employed by private sector entrepreneurs. More likely, a combination of richer immediate markets and better connectivity to both Europe and the rest of the world means that the South East will remain the destination of choice for most private sector entrepreneurs in the decade ahead, just as in recent decades.

The biggest hope for areas outside the South East are the restrictions on "garden grabbing", which the National House Planning Advisory Unit's house price model predicts will lead to a doubling of house prices in London – to an average of £500,000 in real terms by 2025. At that price those who do not inherit simply won't be able to move to London and the surrounding area, at which point university towns such as Liverpool, Leeds and Newcastle are likely to retain a higher proportion of their graduates. That will be good for their local economies, but will come at a high price to the overall economy. An economic variant of "pass laws" is unlikely to be the best way to run the UK economy.

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