

The 2010 Comprehensive Spending Review: The economics of the cuts agenda are neither justified nor just

Last week's Comprehensive Spending Review detailed the largest cuts to public spending since the Second World War. In [John Van Reenen's](#) judgement, the speed and scale of the cuts are not economically justified because the previous government's plans would have also dealt with the deficit with much less danger to the economic recovery. The Review is also unjust, hitting the poor much harder than the rich.



Last week Chancellor Osborne spelled out the details of the most draconian spending cuts in a generation. He believes that these were economically inevitable and morally justified; in the words of Mrs Thatcher "There Is No Alternative". I disagree – cuts on this scale are not an inexorable law of economics, but rather a political choice.



Earlier that week I met one of President Obama's senior economic advisers in Washington to discuss US policy, and the contrast to the UK was stunning. The focus in DC is how to create growth and sustain jobs. The obsession in London is balancing the budget in a single parliament.

In the October Spending Review £80.5 billion of cuts were announced (a minor revision down from £82.8 billion in June's 'emergency budget'). The plan is to reduce the budget deficit from around 10 per cent this year to 2.1 per cent in 2014/15, with the aim of stabilising the national debt. This would mean a drop in borrowing from £149 billion in 2010/11 [to £37 billion in 2014/15](#).

The question is *not* whether the deficit has to be brought down: it does. But serious deficit reduction would also have happened under the previous administration. The difference is that the coalition has accelerated the deficit reduction plan and increased the bloodletting in public spending. The fiscal tightening is 6.2 per cent of GDP by 2014/15 compared with 4 per cent under Labour and it is [beginning sooner](#) (e.g. 2.1 per cent by 2011/12 compared with 1.1 per cent). Labour would have halved the deficit by 2014/15, Chancellor Osborne plans to eradicate it completely. Between now and 2014/15 the coalition will cut public spending from the £50.9 billion planned under Labour to £80.5 billion.

Why the plan is wrong

Unjustified: Needless risks to economic recovery

The British economy is in a fragile state – removing big chunks of demand in such a time is a very bad idea. It risks pushing the country into another recession, which would make the public finances worse rather than better. More importantly, it will prolong unemployment risking a return to the long-term jobless rates that were the norm in 1980s Britain.

The government claim that the bond markets need additional 'assurance' that Britain is tackling the deficit. There is no rational reason why this should be the case. Public debt levels are around £953 billion, [which at around 65 per cent of GDP](#) is well below the average of the last three centuries (118 per cent between 1688 and 2010). And Britain has never formally defaulted on its debt ([there is a historical debate over whether the 1932 events of the inter-allied debt and reduced coupon were defaults or not](#)). So talk of us being 'bankrupt' and going the way of Greece is really just scaremongering.

The government argues that the IMF has given the austerity programme its official blessing. In fact, things are much more nuanced. If one actually reads the latest [IMF World Economic Outlook](#), it clearly spells out the likely falls in output caused by severe deficit reduction. The IMF argues that fiscal consolidation has particularly severe effects on reducing GDP when (i) other countries are simultaneously cutting their deficit (so there is little foreign demand to pull up exports) and (ii) monetary policy is weak because interest rates are near zero.

Both of these factors are now at hand and in such a situation the IMF suggests reducing the public spending to GDP ratio by 1 percentage point will cause about a 2 per cent fall in short-term output. I support

quantitative easing, but I am not convinced that this will be sufficient either in Britain or the US to counterbalance a fiscal retrenchment on the scale currently planned.

The IMF's analysis is consistent with that of my colleague at LSE's Centre for Economic Performance, Ethan Ilzetzki, who has shown by looking at data from 48 nations over several decades that in the right environment stimulus programmes can and do work. Another CEP colleague and new Nobel laureate, Chris Pissarides' life work points to the severe costs of long-term unemployment. I concur with his view that the government is cutting "[too much too quickly](#)".

A sensible plan would be to slow the deficit reduction while the world climbs out of recession. This was broadly the policy under the last Labour government. The stimulus programmes and bank bail outs – opposed by many Conservatives – prevented a second great depression. We seem to be suffering from a kind of collective economic amnesia, with the deficit being blamed on uncontrolled spending whereas it is fundamentally the creature of the recession. The political fall-out has boosted the right, strengthened the deficit hawks and now risks a repeat of what happened in the US in 1937 and Japan in 1997 when premature withdrawal of demand led to a double dip recession.

Unjust: Hitting the poor where it hurts

The coalition claims that the deficit reduction programme is "fair". Under any reasonable use of language, it is not. The government's tax and benefit reforms mean that (with the exception of the richest 2 per cent of the population) the poor will pay a proportionately larger fraction of their income than the rich. Without the tax increases already announced by Labour it would be even more clearly regressive. And if we factor in that the public services are disproportionately consumed by the poor then it would be even more regressive still.

So the denial of this fact by the Prime Minister and his Deputy relies on some fancy verbal footwork over what "fairness" is. To be charitable perhaps they mean "fair" for future generations by reducing the deficit. There is definitely an intergenerational issue due to pension and health liabilities, but whether the current deficit is dealt with in 2014/15 or 2017/18 will hardly make a difference to those very long-term problems. And in any case, as I argued above, if the deficit is actually made worse by premature cuts then we will hurt both current and future generations.

It ain't all bad

Lest I be accused of being hopelessly partisan, let me point out that there are many elements of the government's package I support.

First, raising the retirement age to 66 by 2020 is the right thing to do as people are living longer and healthier. I have little sympathy for the French antagonism to raising the retirement age to 62.

Second, removing child benefit from higher earners is also right (although explicitly means testing or taxing it would have been simpler).

Third, implementing the Browne Review and abolishing the fees cap is the only way to save our universities – one of Britain's few world-class industries. I hope the government does not lose its nerve here or use this as a cover for simply withdrawing money from the university system still further.

Fourth, I support the concept of a pupil premium to help pupils from low-income families improve their school resources. But combining this with an 11 per cent cut in the education budget means only a very small real increase in current expenditure combined with a massive cut in capital investment.

Fifth, the idea of a universal benefit combining and simplifying the existing web of benefits and tax credits is right. The problem is in executing this. Changing Council Tax Benefit into a discretionary grant for local authorities will actually accomplish the opposite.

Overall, deficit reduction does offer an opportunity to increase public sector productivity that can and should be greater. There are many ways to do this through improving management practices as I have argued [elsewhere](#).

Why pursue an unnecessary policy?

Why did the coalition move so far from the March 2010 deficit reduction plan? I have heard ministers say "it's simply arithmetic"; but this isn't true – there is a sound economic basis for a more gradual exit strategy. I think the fundamental reasons for extreme austerity are political and ideological.

On the political side, pushing through maximum pain now enables them to say that it was all the fault of

Labour wasting money. This is what most new CEOs do – get the bad news out, sack a bunch of people and blame the old lot. The high deficits shared by most advanced nations are overwhelmingly due to the recession, stimulus packages and bank bail-outs. The Keynesian policy responses helped save us from a near death experience for the global economy.

The previous government did have some culpability for two reasons. First, weak financial regulation and the implicit bailout promise led banks to indulge in overly [risky behaviour](#): but remember that the Conservatives were arguing for even more deregulation, not less. Second, more should have been done to reduce the structural deficit when times were better. There is no harm with high public spending *per se* – the Scandinavians seem to manage it pretty well. But taxes have to be raised by more than the Labour government was prepared to do in order to pay for them.

Beyond raw political tactics, Conservative ideology plays an important role in extreme austerity. The explicit aim is to cut back the size of the state quickly to where it was in Labour's early days of the late 1990s. The next stage will be to go even further. There does not seem to be much of a coherent view of what the state should do, however, and the shape of the budget seems to be focused mainly on just cutting. Many economic liberals would cheer this as a good thing – the smaller the state the better. Yet the coalition seems reluctant to wear the mantle of Thatcherism. It would be better if they were honest and accepted that this indeed is what they are doing.

The coalition's extreme austerity policy is the biggest economic gamble I have seen a British Chancellor take in my lifetime. With my heart, I hope for the sake of the country the wager pays off, but in my head I fear that this unjust, unjustified and unnecessary programme will cost us dearly as a nation.

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