

Autumn Statement 2012: There are bigger challenges awaiting George Osborne

Following the Chancellor's Autumn Statement last week, the Nobel prize-winning economist, [Christopher Pissarides](#), discusses the need for greater investment to bolster growth, the impact of reducing in real terms the job seeker's allowance amongst other benefits to economically disadvantaged families, and the delicate balance between providing the poorest with good social welfare services whilst keeping taxes low.



Being Chancellor of the Exchequer has never been an easy job. The bad news is that it will get worse. Britain needs a fundamental re-think of its economic policy, in view of changes in the structure of society and the world economy. The more urgent problem is to get the country out of recession and restore balance in the government's accounts. This was the Chancellor's focus in his autumn statement. But the problems that he had to deal with are closely linked to the longer-run dilemmas that sooner or later he will have to face.

The key issue is that the gap between spending and tax revenue is too large and unsustainable. Of course, we all want to see low taxes, low debt and a sound social welfare system. But how do we achieve them? Societal changes are putting more pressure on the financing of a social welfare system that has become part of the British way of life: a universal health service, high-quality education, generous transfers to the poor and good pensions. But our expectations of the quality of health care are rising, more of our children want to stay in full-time education and our life expectancy is rising. All these put more pressure on the government's spending plans, and it is difficult to see what might reduce it in the future. It will get worse. At the same time we have come to expect, and demand at the polls, lower taxes, a legacy perhaps of the Thatcher era. And international lenders demand lower debt levels, making deficit financing unsustainable. How do we finance the public services that we expect?

The Chancellor has done the obvious and increased some taxes, is requiring more spending cuts, and is keeping fingers crossed that Europe and the world economy recover soon and their consumers buy British goods. But this is not enough. The economy needs more investment and more domestic spending to recover. Although the shifting of public spending from current to investment spending and the additional tax incentives given to companies to invest are welcome, more should be done on public investment. It has been neglected over the last few years with negative impact on productivity growth and job creation. Investment eventually pays for itself but it needs time; including it in the current budget balance as if it were a one-off expenditure with no revenue prospect is a mistake. The level of public investment is sufficiently low that spending should now have a high rate of return. More could be done without putting at risk the timescale for debt reduction.



Credit: Conservative Party (CC)

Private spending will not be helped by the autumn statement. Scrapping the fuel duty and refusing to introduce a mansion tax may be good for votes but such duties and taxes do not affect spending much. Reducing in real terms the job seeker's allowance and other benefits to poorer families is bad for private spending because the unemployed and poorer families do not have savings to maintain their consumption levels.

Before the election some colleagues and I [signed a letter](#) to a national newspaper, supporting a planned reduction in the national debt within the life of this parliament. Two years ago, at the start of the Eurozone debt crisis, I said that the chancellor's debt reduction plans went too deep too quickly and although they were likely to please the foreign rating agencies, they were unlikely to help the recovery. The revisions to the plans since then have brought the deficit reduction plan back to where I thought it should have been in 2010, at some displeasure to the rating agencies. We should not be concerned about that, just as the Obama administration was not concerned about it when it took a different approach from George Osborne's to the recession. Instead, we should be concerned about job creation and productivity growth, which are needed to bring us out of recession.

But the big picture remains bleak and the big question remains unanswered. How do we plan to balance the desire to have generous transfers to the poor and good quality health and education services on the one hand, with the low taxes and deficits that voters demand on the other? Either this or future Chancellors will have to answer this question. Otherwise we will be muddling through papering over the cracks when the real need is to fix the foundations.

This article originally appeared on the [British Academy Policy Centre](#)'s website as a [Policy Perspectives](#) piece.

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About the author

Christopher Pissarides is School Professor of Economics at the London School of Economics and a Fellow of the British Academy. In 2010, he was a recipient of the Nobel prize in economics for his work on the theory of search frictions and macroeconomics. Professor Pissarides' interests include the macroeconomics of labour markets, structural change and economic growth.

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