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Policy Paper

From Deficit Panics to Economic Renewal

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Executive summary

The responsibility of government is not to balance the budget but to balance the economy by moving it to full employment. This duty should be the guiding principle for macroeconomic policy, but has been set aside in recent years. The reigning political ideology of the past seven years has twisted economic policy into a method by which to undermine the state and erode the social infrastructure that the majority of the public depend on. It is time we move from a period of austerity to one of public investment with a focus on developing an economy that produces well-paid jobs. To do this we need three things to happen in tandem:

1. A dismissal of economic gimmickry

Two core lies have been told to justify the public spending cuts since 2010. These lies must be challenged on every occasion.

(i) Reducing and then eliminating the government budget should be the primary focus of government expenditure and tax plans: Since 2010, the government has continually presented the size of the budget deficit as the most pressing issue in macroeconomic policy. Proponents of austerity claim that government borrowing places a debt burden on future generations, but the truth is government bonds are an asset for individuals and pension funds. Failure to invest in key areas – including health, education and in greening the economy – impose huge social and economic costs on this, and future, generations.

(ii) Fiscal consolidation and austerity will lead to a smaller budget deficit and higher growth: Since 2010, Conservative-led targets for reducing the deficit have been consistently missed. Continuing to aspire to these targets will further damage our economic recovery. The UK has already experienced its weakest recovery on record, undergone the worst decade for productivity growth for two centuries and suffered the lowest investment of all G7 countries since 1997.

2. Building a new and honest narrative of how the economy works

The reason Conservative-led governments have been able to develop and apply an economic policy which has no grounding in evidence is in part due to a lack of basic economic literacy across key actors and influencers in the public sphere. There are two areas where we need to ensure the public are no longer misled:

(i) There is a magic money tree: The key question when considering ideas of increased public expenditure and investment is not whether money is available: the Bank of England can provide money and borrowing is readily possible at historically low rates of interest. There is also huge potential to raise tax revenue through a more progressive tax system and a clampdown on tax avoidance.

(ii) The appropriate size of budget deficit should be judged by the level of unemployment: Setting arbitrary targets for the budget, as has been the approach of both this and the previous Chancellor, without accounting for current levels of unemployment is nonsense. When there is significant unemployment and underemployment then it is appropriate to expand public expenditure and the budget deficit to help bring down unemployment.

3. A new focus for macroeconomic policy: Good jobs

There should be no attempt to strive for a budget surplus through public expenditure cuts or through tax rises. A smaller deficit or budget surplus must be brought about through higher levels of investment and an improved net exports position.

We need a purposeful fiscal policy striving to achieve secure and well-paid full employment. This can be approached through socially beneficial public expenditure (notably on health, social care and education) and public investment on infrastructure and environmental sustainability. A progressive tax system tackling tax avoidance would go alongside enhanced public expenditure. Fiscal policy can help to create the conditions for secure and well-paid full employment, but it cannot do so by itself. It has to be accompanied by both labour market policies raising wages and reducing insecurity and an industrial strategy promoting investment in innovation regionally to address inequality.

Introduction

Debates over public expenditure, taxation and fiscal policy over the past near decade have been dominated by the 'need to eliminate the budget deficit'. This is more technically referred to as 'fiscal consolidation', which involves reducing the government budget deficit and outstanding government debt. The policies that have followed have involved reductions (at least relative to GDP and to social need) in many parts of public expenditure, including health, education and policing. This package of cuts is widely termed 'austerity.'

One dictionary's definition of austerity is 'a situation in which people's living standards are reduced because of economic difficulties' (Collins English Dictionary). The need for austerity and reduced living standards can arise from the destruction of war, the failure of harvests and so on, and a general lack of resources. But the austerity from public expenditure cuts comes not from a lack of resources, but from a drive to reduce budget deficits when there are resources available – people unemployed. As such, the last seven years of austerity, pursued to reduce the budget deficit (the difference between public expenditure and tax revenue), is a matter of political choice.

The success of the narrative of austerity, despite its lack of economic rationale, deserves exploring. This paper charts how this approach took root and the misconceptions that have allowed it to continue. It highlights how austerity has failed in economic terms, illuminating the missed debt reduction targets and impacts on economic prosperity. It ends outlining a new focus – one of good job creation – to usher in a new era of macroeconomic policy based on evidence and in line with maximising the human and environmental well-being of this country.

How we got here: Debt scare tactics

Developing a ‘deficit panic and debt scare’ was a central feature of the Coalition agreement between the Conservative and Liberal Democrats drawn up immediately after the general election of May 2010.[1] The agreed approach set the scene for the nature of the austerity programme pursued by the Coalition government and continued and reinforced under the present Conservative government. The Coalition agreement was based on the notion ‘that deficit reduction, and continuing to ensure economic recovery, is the most urgent issue facing Britain’. It committed the Coalition partners to ‘significantly accelerate the reduction of the structural deficit over the course of a Parliament, with the main burden of deficit reduction borne by reduced spending rather than increased taxes’ (Cabinet Office 2010, p.15).

The emergency budget of June 2010 (HM Treasury, 2010) set out the intentions to achieve budget deficit reductions at a faster pace than had been envisaged by the outgoing Labour government, with around 80% coming from cuts in public expenditure and around 20% from rises in tax rates. Later, the Treasury claimed that ‘this approach is consistent with OECD and IMF research, which suggests that fiscal consolidation efforts that largely rely on spending restraint promote growth. Tax measures can be an effective tool for reducing the deficit quickly, allowing for phased reductions in public spending. The government’s consolidation plans therefore involve a rising contribution from public spending over the forecast period’ (HM Treasury 2011, p. 15).

There were three important though erroneous arguments being advanced here:

1. The budget deficit reduction is the most urgent problem facing the country. It is rather ludicrous to portray deficit reduction as the most urgent issue facing Britain without mentioning high levels of inequality and poverty, unemployment, environmental concerns from climate change, stagnant productivity and real wages, the scale of the current account deficit, not to mention addressing the financial crisis and its causes. The claim is made without any recognition that the budget deficit rose rapidly in 2008 and 2009 because of the recession following on the financial crisis as tax revenues slumped. Elevating the elimination of budget deficit to the 'most urgent' problem detracts political attention from addressing those other and much more important issues. Indeed, the ways in which deficit reduction was approached exacerbated those other economic problems.

2. Deficit reduction, fiscal consolidation and austerity leads to economic recovery. Indeed, it is reductions in public expenditure and austerity which threatened the recovery. Economic recovery comes from a revival of demand, whether from investment, exports or consumer expenditure, and the budget deficit will decline as a result as tax receipts rise. Rising budget deficits go with recession, and falling budget deficit goes with economic recovery, but it is economic recovery which brings about budget deficit reduction and not the other way round.

3. The third erroneous argument comes from the emphasis on cutting public expenditure coupled with limited increases in tax rates. This was a crucial decision for it clearly put the emphasis on reductions in public expenditure, hurting those who use and rely on public services and social security the most. The research from the OECD and IMF claimed in support of this approach is of dubious merit. The 'deficit panic and debt scare' were being used as the smoke screen for reducing state activity. How often have we heard a policy of cuts to public expenditure being defended on the basis that 'the deficit has to be dealt with'? A

policy cutting public expenditure (e.g. the reduction in the number of police officers) is not defended on the basis that such expenditure is wasteful and is not socially beneficial, nor is it defended on the grounds that society's resources can be better deployed elsewhere. Its only 'merit' appears to be that the budget deficit may be cut as a result.

Various justifications and rationales for fiscal consolidation, deficit reduction and austerity have been advanced by the Coalition and Conservative governments (and regrettably echoed by many Labour politicians). The justifications and rationales simply do not hold water.

'Debt burden on future generations'

One of the most frequently heard arguments for reducing and eliminating the budget deficit is that the government borrowing which is entailed is an intolerable burden on future generations – the fate of our grandchildren being frequently invoked. Two quotes from the recent Conservative party manifestos provide illustrations.

1. 'And failing to control our debt would be more than an economic failing; it would be a moral failing – leaving our children and grandchildren with debts that they could never hope to repay … Our long-term economic plan reflects our values: we as a nation should not be piling up and passing on unaffordable levels of debt to the next generation' (Conservative party, 2015 p.8).
2. 'The greatest impact a government can have on future generations is the amount it chooses to borrow to pay for current spending' (Conservative party, 2017, p. 63)

A budget deficit does, of course, involve government borrowing and adds to the government debt, though the ratio of government debt to national income only increases if the debt is growing more quickly than national income. Government bonds are a debt of the government on which interest will be paid and at some stage the principal repaid, but they are also an asset of those who have purchased them.

Government bonds are an important way in which people hold their savings and in which pension funds place their assets. Government bonds should then be considered as an asset which may well be inherited by our grandchildren if we so desire. The interest which is payable on government debt is in effect a transfer from one group (taxpayers) to another group (bond holders).

Currently around a quarter of government bonds are held by the Bank of England (hence the government is in effect paying interest to its own agency), a quarter by pension funds (and thereby contributing to private pension payments), a quarter by private individuals, and a quarter by foreigners). It is often argued that interest payments made by the government could be used for other purposes, which forgets that the borrowing had paid for previous public expenditure. Further, the historic experience has been that the government has borrowed more each year than the interest payments on past debt – the government borrows from one set of rentiers to pay interest to another set of rentiers.

It is austerity itself which can impose major and real burdens on future generations (as well as on present generations). The burdens come from cuts in public expenditure, which means lower expenditure on education and on health, and less investment in infrastructure. High levels of unemployment, particularly amongst the young, can scar the unemployed well into the future as their future job prospects opportunities are harmed. It should be the moral duty to ensure the next generation are not scarred now by the experience of unemployment, and that resources which otherwise stand idle are used to invest in the future. The greatest impact which government can have on future generations surely comes from the ways in which it approaches sustainability, climate change and environmental protection.

'It's like the credit card being maxed out'

If the UK government had not borrowed around £70 billion in the financial year 2016/17, then people (including through pension funds) would not have been able to save the amount they did. The government borrowing enabled people to realise their savings intentions – without the government steeping up to borrow, there could not be that volume of savings. The time for government borrowing is precisely the time when people and corporations wish to save more than they wish to invest, and the government is able to borrow from the private sector.

This is not to argue that there is no limit on how much the government can and should borrow. But rather than an arbitrary percentage of GDP, the amount the government should borrow should be guided by the amount the private sector would want to lend when the economy is operating at full employment - the difference between the amount the private sector wants to save and the amount it wants to invest. Borrowing more would 'crowd out' private investment; borrowing less would lead to less savings and unemployment. The government's credit card is only 'maxed out' when full employment is reached in the sense that it should not be increasing the scale of its borrowing, though the government would need to continue its borrowing.

Attempts to portray the government like a household have an intuitive appeal but can be severely misleading. Government spending has a marked effect on government tax revenue – government's payment of wages is subject to income tax and national insurance contributions, and government spending has multiplier effects on economic activity which yields tax revenue. The government has its own bank – the central bank – which is able to finance its expenditure further explained below. But most of all, the government's responsibilities are the provision of high quality socially beneficial public services, progressive taxation and arranging its budget position to secure high levels of employment.

There is the similarity that if a household cuts back its expenditure, it will reduce demand in the economy, as will a government – and if households cut back together then the economy will fall into recession. Similarly, if firms cut back on their investment programmes, the economy will enter recession – as happened in the aftermath of the financial crisis in 2008. In those circumstances, it becomes the responsibility of government to not cut its expenditure and further exacerbate the recession – a responsibility which government accepted to some degree in 2008/09, limiting but not preventing the extent of the recession. The responsibility of government is not to balance the budget, but to balance the economy by moving it to full employment.

'There isn't the money'

It is remarkable that when Labour (and others) propose to increase expenditure in some way, the cry goes up that 'there is no 'magic money' tree.' When the Conservatives find it expedient to increase spending – the additional money for Northern Ireland to secure the support of the DUP for the Conservative minority government is the clearest example—there appears to be no problem in terms of the availability of money.

The reality is that as far as government expenditure is concerned, money is always available. The money spent by government is what may be termed central bank money – the government draws on its account with the Bank of England in order to spend, and there is then a corresponding increase in the recipients' bank accounts (and banks have their reserves at the central bank increase as their customers' bank deposits increase). This spending by government using central bank money happens every day of the week – government draws on its account at the Bank of England and makes payments – whether on welfare benefits such as pensions, child benefit, wages and salaries of government employees, or private contractors supplying goods and services to the government. And every day of the week money returns to the government and into its account at the Bank of England – payment of taxes being the predominant reason.

Government expenditure actually precedes tax revenue. If money has not been created through government expenditure, it cannot be paid back in taxes. Government expenditure directly creates tax revenue – those employed by the state pay income tax and national insurance on their earnings; the employees spend their (post-tax) income, thereby paying further in value-added tax and so on, and also creating further jobs (effectively the multiplier effect).

If you want to buy something, you may say that you do not have the money. But if you were only able to work 20 hours a week when you would like to work 40 hours, then the reason you cannot buy is because you are not able to work as much as you would like and earn more.

For the economy as a whole, the ability to produce is limited in the end by the resources available – the people, the machines, and so on. If there was full employment, it would be right to say that there are not the resources to have more undertaken by the public sector unless less is undertaken by the private sector. But when there is unemployment or underemployment, the resources are there to produce more in both the private sector and the public sector.

Instead of being concerned as to where the money will come, the first question on any proposed expenditures should be whether such expenditures will provide socially beneficial and desirable services or provide income to people. There has to be consideration of the availability of the necessary resources (notably people) to enable the services to be provided, whether those resources will be drawn from other activities or from the pool of unemployed, and whether the required specialised skills are available.

The funding arrangements for the expenditure also have to be reckoned with. Much of the money spent by government returns to the government in the form of tax receipts, and more can be returned through the government selling its bonds. A highly simplified set of accounts for consolidated government and central bank would involve: government expenditure = tax revenues plus net sale of bonds plus change in central bank money held outside government.

What is termed central bank money (that is money created by the Bank of England) takes one of two forms – it is of reserves held by clearing banks with the central bank, and notes and coins held by the public. How much government expenditure should be funded by tax revenue, how much by the sales of bonds and how much by changes in central bank money should depend on the general state of the economy: how much additional central bank remains in circulation, and what is the appropriate scale of government borrowing.

'We're living beyond our means'

The government budget deficit is often portrayed as us 'living beyond our means', as the government is spending more than it is receiving in tax revenue. A government deficit does mean that the public is in a sense receiving more from the government (the benefits of expenditure) than it is paying to the government (in the form of taxes). But to say that the country is living beyond its means because there is a budget deficit is to confuse the government with the country.

There is, though, a way in which the UK and its people (rather than the government) is currently living beyond it means – that is the current account deficit. The current account deficit is made up from the trade deficit (the excess of imports over exports) and the net income (remitted profits and royalties by multinational companies, interest paid, labour earnings) position with the rest of the world. The current account deficit has to be covered by borrowing from overseas, and it is that deficit which at some stage will need to be addressed. The recent record on the current account deficit and its tendency to grow are briefly indicated below. It is that current deficit which will at some point have to be addressed.

The great austerity failure

The last seven years have seen a succession of budget deficit reduction and elimination targets being set for up to five years ahead. The precise nature of the targets has shifted – sometimes current budget, sometimes total budget, sometimes actual budget, sometimes cyclically adjusted. The continuing story is, though, of failures to achieve the deficit targets.

In the emergency budget of 2010, Chancellor Osborne set the objective of eliminating the cyclically adjusted current budget deficit by 2015/16 (that is the budget excluding capital investment and adjusted for the level of economic activity). The route to deficit elimination was largely to come from cuts in public expenditure with minor tax rises. The overall net borrowing by government ('public sector net borrowing') was intended to decline from 11.0% of GDP in 2009/10 and a forecast 10.1% in 2010/11 to 1.1% in 2015/16, with the current budget into balance (and on a cyclically adjusted basis into a small 0.8% of GDP surplus). In the outturn the public sector net borrowing was 3.8% of GDP in 2015/16 and the cyclically adjusted current budget deficit 2.0% of GDP.

It would be possible, though tedious, to go through budget statement by budget statement to detail the continual failures to meet deficit reduction targets and the shifting of the targets. Let us instead fast forward to 2015, when further fiscal consolidation was considered 'necessary to ensure that debt keeps falling as a share of GDP and to deliver a balanced structural current budget in 2017-18, meeting the new fiscal mandate that Parliament voted on earlier this year' (Conservative manifesto 2015 pp.8/9). However, 'a balanced current budget is not enough to deliver a reliable reduction in our level of national debt, which remains far too high in a world of continuing economic challenges. International evidence and Treasury analysis shows that the only way to keep our economy secure for the future is to eliminate the deficit entirely and start running a surplus. Anything less would be to ignore the lessons of the past' (Conservative manifesto, 2015, p.9).

A 'Charter for Fiscal Responsibility' was introduced in 2011, following a succession of previous similar named codes, in which the deficit and debt targets were formally set out. In a speech to at the Mansion House, London in June 2015, the Chancellor of the Exchequer announced his intention 'that, in normal times, governments of the left as well as the right should run a budget surplus to bear down on debt and prepare for an uncertain future', and that 'in the budget we will bring forward this strong new fiscal framework to entrench this permanent commitment to that surplus, and the budget responsibility it represents.' (Osborne, 2015).[2]

In the revised Charter for Fiscal Responsibility, the Treasury's mandate for fiscal policy was set as 'a target for a surplus on public sector net borrowing by the end of 2019-20' and in 'normal times', once a surplus has been achieved, as 'a target for a surplus on public sector net borrowing in each subsequent year'. The mandate was supplemented by 'a target for public sector net debt as a percentage of GDP to be falling in each year'. These targets could be lifted if in the assessment of the Office for Budget Responsibility there was a 'significant negative shock' which was defined as growth of less than 1% per annum.[3]

There have been further revisions to the Charter for Fiscal Responsibility. In the version of Autumn 2016, the Treasury's objective becomes to 'return the public finances to balance at the earliest possible date in the next Parliament [i.e. after 2020]' and 'a target to reduce cyclically-adjusted public sector net borrowing to below 2% of GDP by 2020-21'. The mandate is 'supplemented by: a target for public sector net debt as a percentage of GDP to be falling in 2020-21' and 'a target to ensure that expenditure on welfare in 2021-22 is contained within a predetermined cap and margin set by the Treasury at Autumn Statement 2016' (Charter for Budget Responsibility: Autumn 2016 update). This was echoed in the Conservative election manifesto of 2017 with 'we will continue with the fiscal rules announced by the chancellor in the autumn statement last year, which will guide us to a balanced budget by the middle of the next decade' (Conservative party, 2017, p.14).

The pattern on the budget deficit targets has been one of setting them for a number of years ahead, a failure to meet those targets and then pushing back the date at which some form of budget balance or surplus is to be achieved. This has now been combined with setting the aim that after a budget surplus has been reached that it be maintained. It is instructive to first enquire why there has been the failure to meet the deficit targets, and then to ask whether running a budget surplus is feasible.

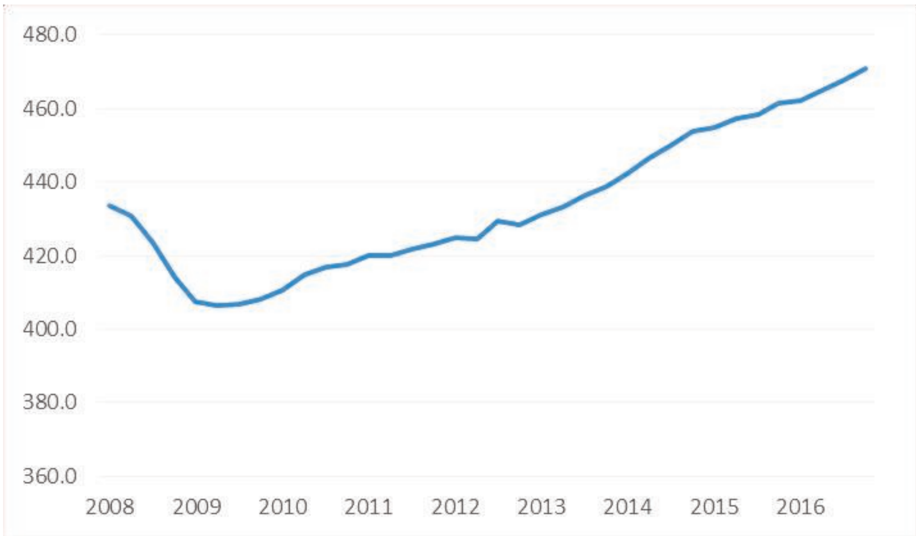
The change of chancellors from Osborne to Hammond brought some shifts in declared targets for budget deficits and public debt – the changes from the Charter for Fiscal Responsibility 2015 to that for 2016 mentioned above illustrate that. They can be seen as some further pushing back of the dates for achieving a balanced budget, and dropping Osborne's fascination with trying to achieve the unachievable of budget surpluses on a permanent basis. These shifts could accommodate some increases in public expenditure (as compared with what was previously scheduled). However, the changes do not address the basic problem that deficit and debt targets are set without regard to the state of the economy, the feasibility of achieving them, or their desirability.

The failure to reach the deficit reduction targets can be ascribed to the slow recovery from the financial crisis and its after effects. Figure 1 portrays the path of output and of output per person. The slow rate of recovery, and particularly the failure of productivity (output per person hour) to grow at anything like the rate observed prior to the financial crisis, are clearly evident. The sluggish performance of productivity and the associated failure of living standards to rise has added to the feelings of austerity.

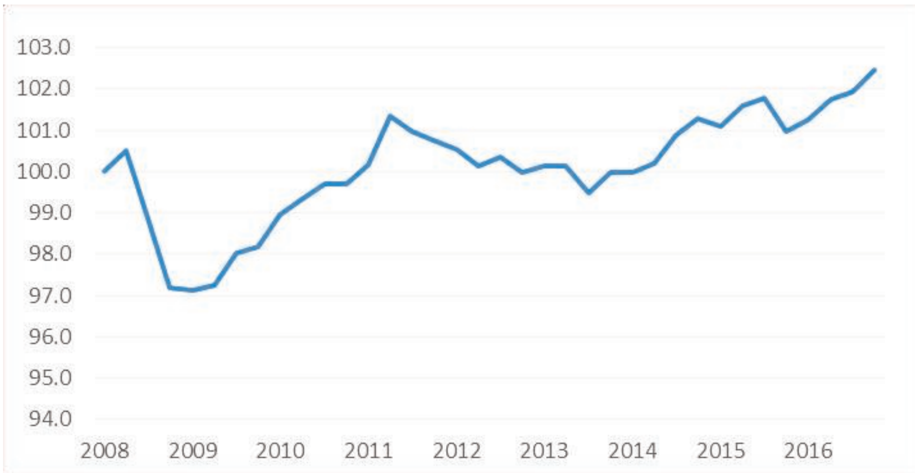
The slow rate of output growth has meant that tax revenues did not rise as anticipated and help to explain the failure to meet deficit targets.

Figure 1 Growth of output and output per person hour since 2008

(a) Gross Domestic Product (Quarterly £billion 2013 prices)



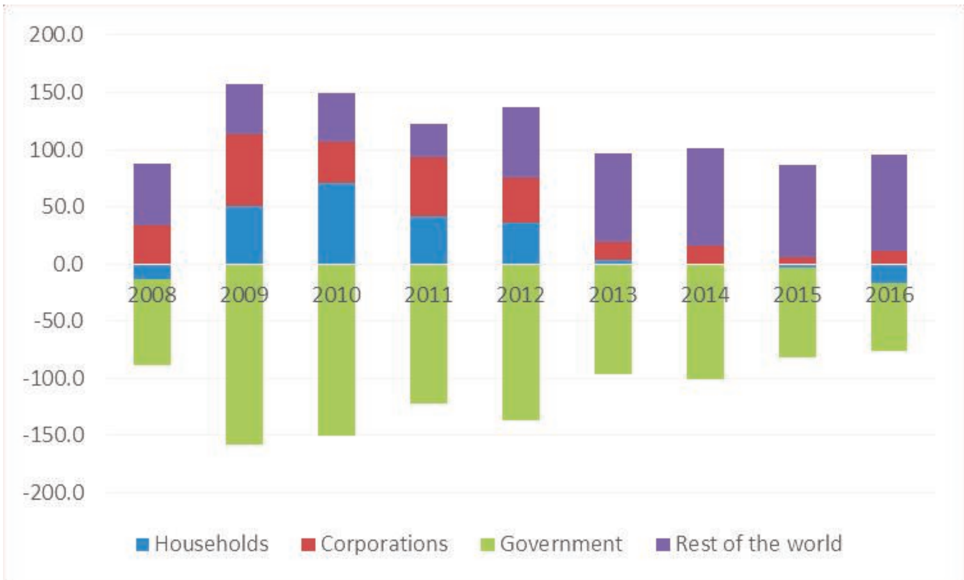
(b) GDP per person hour (2008 = 100)



Source: Calculated from Office for Budget Responsibility, Supplementary Economy Tables, March 2017

Another way of viewing the budget deficit is to relate it with its counterparts of private net savings (savings minus investment) and capital account inflows. One person's borrowing is another person's lending. And one sector's borrowing is another sector's lending: if the government is borrowing it has to be that the private sector is lending. The key relationship then is that public sector borrowing is equal to private sector net lending plus lending by overseas. The borrowing by the public sector is the difference between its (tax) revenue and public sector expenditure (current, capital, transfer payments and interest on debt). The private sector net lending is the difference between private savings (by households and corporations). The lending by overseas (and hence borrowing by the UK) is the capital account inflow and is equal to the current account deficit.

Figure 2: Sectoral balances since 2008



Source: Calculated from Office for Budget Responsibility, Supplementary Economy Tables, March 2017

The sectoral balances are illustrated for the years 2008 to 2016 in Figure 2. It is not a coincidence that the sum of the bars above the line (indicating a sector in surplus) exactly equals to sum of bars below the line. Households were in deficit in 2008 as their savings fell as consumer debt boomed, but then were in surplus as consumer expenditure dropped in the recession; there was a return to households being in deficit in 2015 and 2016. Corporations have been in surplus as their savings (retained profits) exceed their investment programmes. Combining the households (which includes many small businesses) and corporations would indicate the extent to which the savings of the private domestic sector exceeds the investments being made by the sector.

The rest of the world is shown here as being in surplus which means that there is a capital inflow into the UK. Corresponding to the capital inflow there is a current account deficit (which is in effect funded by the capital inflow). The widening of the rest of the world entry indicates increased borrowing from the rest of the world and rising current account deficit. The government position is in deficit and corresponds to the budget deficit (that is the public sector net borrowing requirement).

These sectoral balances and the relationship between them (that they add up to zero) helps illustrate two important points. The first is that a decline in a budget deficit will be accompanied by some combination of falling private sector surplus (which comes from some combination of declining savings and rising investment) and declining capital inflows from the rest of the world (and hence declining current account deficit and improving net exports). The failure of the budget deficit to decline as forecast can be ascribed to a failure of investment to grow as fast as forecast and a similar failure of exports to grow.

The second is that if a budget in surplus is to be achieved, then that would have to be accompanied by either the private sector position or the rest of world position being in deficit. The private sector would be recorded as in deficit if investment exceeded savings: an investment boom or a decline in savings (which would involve many households going into debt). The capital inflow from rest of the world would be recorded in deficit if the current account position turned into surplus (which for the UK has not occurred for many decades).

A budget surplus on a sustained basis would be historically unprecedented in the UK. The achievement of a budget surplus would have to be accompanied by higher levels of investment, lower levels of savings and improved net exports position. If those could not be achieved (and I would argue they are unlikely though possible) then a budget surplus would not be possible.

In the seven years of Conservative led governments since May 2010, public expenditure on goods and services in real terms (that is after adjusting for inflation) has risen at an annual rate of 1%. Over the same period, national income grew at an annual rate of 2%. Slower growth of public expenditure has largely been achieved. The growth of public expenditure has, of course, to be evaluated against the growth of population. Welfare spending has been (and will continue to be under present government plans) the more severely affected.

After adjusting for rising prices, the Office for Budget Responsibility (OBR) estimates that welfare spending in 2009/10 was £191.9 billion (in 2010/11 prices) and has fluctuated within £5 billion of that figure since then, and is forecast to remain in that range through to 2020/21 when the figure is forecast to be £191 billion. In effect, welfare beneficiaries have no share in rising incomes, and welfare benefits fall from 12.4% of GDP in 2009/10 to 10.1% in 2020/21 – a cut of near 20%. In nominal terms, welfare spending rose by some £24 billion between 2010/11 and 2015/16, and is forecast to rise by a further £14 billion by 2020/21. Those rises owe much to benefits uprating for inflation and demographic changes.

The OBR's estimates are that welfare programme cuts had the effect of reducing benefits by a total of £23.4 billion in 2015/16, of which £3.8 billion came from cuts announced prior to the Coalition government and £19.6 billion from Coalition government cuts. By 2020/21, the estimates are for £57 billion of cuts of which £11.6 billion are pre-Coalition, £33.6 billion from the Coalition government and £11.8 billion from the Conservative government.[4]

Moving forward: A new focus on jobs

The policies which have been pursued for the past seven years have not succeeded in achieving the elimination of the budget deficit, though the deficit has now returned to around the level (relative to GDP) before the financial crisis. A major reason for the slow reduction of the deficit is simply the sluggish growth in the economy.

Austerity (fiscal consolidation) has not brought about economic recovery. Austerity does not work—by which we mean that austerity does not lead to the reduction in budget deficit on the scale envisaged, and austerity does not cause a revival in the economy. Austerity will not bring about growth, though growth will bring about a lower budget deficit.

The essential critiques of fiscal and budgetary policies are that much has been driven by targets of budget deficit elimination which have been unsuccessful. Setting budget in surplus targets are generally unrealistic so far as the UK is concerned. How should budget positions be approached?

The target for the budget deficit and fiscal policy should be to balance the economy – achieving sufficient demand for full employment, counteracting the imbalances in the private sector and with the rest of the world. The route to a low budget deficit (or even surplus) comes from reducing the current account deficit, from higher levels of investment. The elimination of the budget deficit has been treated as dictating economic policies: there is rather the need to view the budget position as the servant of macroeconomic policy.

The programme of severe constraints on the growth of public spending has clearly damaged the health service and education provision (amongst others). The cuts to welfare programmes have had severe effects on those requiring support. It has all been justified on the need to eliminate the deficit, without regard to the costs to society of the cuts. The need now is to rebuild public services and welfare provision.

Central bank money can always be created in order to finance public expenditure, as explained above. The more serious matter is how far public expenditure should be funded by tax revenue, and how much by borrowing, whether by the sale of government bonds or through an increase in the stock of central bank money. In other words, the question is how large the budget deficit should be, and how much of that deficit should be met by the sale of bonds and how much by money.

The general principle is straightforward – namely to seek to have a high level of employment producing socially useful products. Translating that general principle into concrete numbers is never easy, and certainly does not translate into a simple slogan. The appropriate scale of the budget deficit (or indeed surplus) depends on the balance between private savings and private investment and the capital inflow from overseas.

Conclusions

The budget deficit reached over £156 billion, equivalent to over 11% of GDP in 2009/10. Since that time, the political imperative to reduce and eliminate the deficit has dominated macroeconomic policies. That imperative has been used as smokescreen for reducing public expenditure, particularly in the area of welfare benefits. Yet that drive to eliminate the deficit has been unnecessary. The deficit arose from the recession which followed on from the financial crisis, and would have declined anyway as the economy recovered. It was clearly politically motivated decisions rather than any economic necessity to focus expenditure reductions and to target those reductions particularly on welfare payments and inadequate funding of health and education.

We must now urgently move to a new approach, focusing back on increasing the number of people in well-paid jobs. This will not only eliminate the painful impacts of austerity on public services but also seek to secure our economic future as we tackle demographic, technological and climate change. Usefully, such an approach will ultimately result in less public debt.

Notes

1. For a more detailed evaluation of UK fiscal policy after the financial crisis see Sawyer (2012).
2. For a detailed critique of Osborne's proposals and forecast of their failure see Sawyer (2015).
3. Quotes and information in this paragraph from the Charter for Budget Responsibility: Autumn 2015 update.
4. Information in this paragraph calculated from Office for Budget Responsibility (2016).

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