# The impoverished fiscal debate

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Published: October 7 2010 23:52 | Last updated: October 7 2010 23:52

When **George Osborne**, the British chancellor, stands up on October 20 to announce his long awaited "cuts", we must at least insist on some essential clarifications. Are they cuts compared with **public spending** in the past fiscal year or compared with the tentative projections for a five-year period left behind by the last Labour government? Are they cuts in money terms or in real terms, taking into account anticipated inflation?

If and when these basic matters are out of the way, we can then move on to the more fundamental confusions behind the current debate. At present there seem to be only two schools of thought. There are those who attach the utmost priority to eliminating the current public sector deficit and who wish to curb government expenditure as fast as they think they can get away with politically. They are opposed by those who want to protect the "public services", even if this means a slower rate of deficit reduction.

The whole debate is based on a complete confusion between views on public spending and views on the role of the budget balance in macroeconomic policy. Logically there are four, not two positions. They are:

1. The deficit must be quickly reduced *and* public spending is too high a proportion of gross domestic product. This is roughly the view of Mr Osborne and leads to his emphasis on the cuts.

2. The deficit must be quickly reduced, but there is nothing wrong with the public spending proportion. This would be the point of view of a stern Labour fiscalist. To find a good example one would have to go back to Philip Snowden, Labour chancellor in 1931. Even he was, however, bounced by the supposedly independent May Committee into proposing cuts in the dole, which split the Labour party and led to many years of Conservative-dominated governments.

3. There is nothing like the urgency to cut the deficit assumed by the media *and* there is no need for further public spending curbs. This seems to be the mainstream view of the present Labour party, insofar as a view can be discerned behind the internal feuding.

4. There is indeed not all that much urgency to cut the deficit, when economic recovery is far from assured and output is well below optimal capacity rates. *But* government expenditure is probably too bloated and needs to be curbed on its own merits or rather demerits. The logic of this position is that expenditure curbs should be offset by tax cuts.

The above 4th is, as faithful readers will have noticed, roughly my own view.

It is hard to believe that the rise in the public expenditure ratio from 38 per cent of GDP at the beginning of this century to the present 47 per cent is in any sense optimal. More than half of this rise reflects expenditure growth rather than the slowdown of GDP in response to recession. And in contrast to the **Republic of Ireland**, the official figures exclude most of the emergency aid to the banking sector. The cries of every imaginable lobby and interest group that any reduction in their level of government support will mean the end of civilisation as we know it hardly helps their cause.

Even the four positions just outlined can be nuanced in different ways. Among those holding positions 3 and 4 there may be a range all the way from Alistair Darling, the former Labour chancellor who wanted to keep to the slower path of deficit reduction he himself laid down, to those extremists (mea culpa) who see the budget balance as a policy variable to be determined by the state of the economy, and not as an accountancy measure. And in defence of position 4, it can be said that a fundamental examination of which activities really belong in the public sector and which should be left to individual citizens or voluntary co-operation will be much better carried out in a calm mood uninfected by deficit hysteria.

It is sad that the debate has become polarised between positions 1 and 3 and so little is said about the other tenable positions, 2 and 4. It is small consolation that the debate is even more polarised in the US, where my friends in the free market Cato Institute organised one of those unfortunate multi-signatory letters to the press opposing the whole concept of fiscal stimulus.

Some American "rightwing" commentators criticise their European opposite numbers for too much emphasis on austerity rather than growth. What on earth do they mean? They are at the forefront of the budget deficit cutters; and if they want an even cheaper money policy than the near zero official interest rates now prevailing they do not say so, let alone explain how to carry it out. I suppose they have in mind supply side policies such as cutting industrial subsidies, reducing labour market "rigidities" and so forth. Not all these policies are immediately popular, to put it mildly. And surely they are easier to introduce when demand is expanding than during an atmosphere of contraction. We need a lobby for economic expansion, but on a competitive free market basis.

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