Cutting the Public Debt: economic science or class war?

Hugo Radice

This week's major intervention in the election campaign has surely been the call by the Institute for Fiscal Studies for the major parties to 'come clean' about their strategies for reducing the public sector debt, if elected. The IFS report has chimed strongly with the overall public attitude in this campaign, which is that politicians are all devious and untrustworthy. The media response to the report has therefore been to pander to this attitude by unthinkingly echoing the IFS position. The *Guardian* asserts that the IFS is "the leading economics think-tank" in the country, clearly implying that its views must be accepted without question.

But why should the IFS be beyond criticism? Is cutting the public debt really an objective economic necessity, or is it actually a deeply political stance, reflecting the interests of the business and financial élites?

To answer this question, we have to look closely at the history of debates about the public finances over the last forty years. During that time, the theory and practice of economic policy has shifted markedly from mainstream Keynesianism of the early 1970s, to the unchallenged hegemony of free-market neoliberalism since the early 1990s. Although there have been many elements in this overall shift – notably

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Editor Jonathan.Pugh@ncl.ac.uk

privatisation of state enterprises, deregulation of financial markets and attacks on trade union rights – the public finances have consistently played a critical role.

There were two key campaigns in particular that have affected the UK: the first during the 'stagflation' crisis of the mid-1970s, and the second during the sharp recession of the early 1990s. Both were paralleled by related shifts in policy prescriptions all across the world economy.

In the mid-1970s, Britain suffered especially sharply from an unprecedented combination of high inflation and the return of mass unemployment. Attempts by successive governments to address these problems started under the 1964-70 Wilson administrations, and continued through the Heath years to the return of Labour in 1974. In the decade from 1964, restricting public spending might be necessitated when sterling was under pressure, but was not seen as the key to macroeconomic stability. Instead, the predominantly Keynesian policy mainstream favoured state initiatives in the form of incomes policies and indicative planning, aiming to reconcile the conflicting interests of employers and unions through the good offices of the state.

But by 1976 these efforts had ended apparently in abject failure, although Keynesians could argue that inflation was significantly the result of factors outside British government control – notably the breakdown of the dollar-gold link in 1971 and the oil shock of 1973. The result was the emergence of two policy platforms standing to left and right of the mainstream. On the left, Labour and the unions flirted with an

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Alternative Economic Strategy which centred on a radical extension of state intervention in the modernisation of British industry. On the right, the monetarists led by Milton Friedman offered an equally radical alternative diagnosis of stagflation, blaming it on the fiscal and monetary indiscipline of the government.

Following a sudden dip in Britain's trade balance in 1976, a run on the pound forced Chancellor Healey to turn to the IMF for help. The public spending cuts that followed signalled an early victory for the monetarist right, and the end of the road for both mainstream Keynesianism and the leftist Alternative Economic Strategy. Mrs Thatcher's election success in 1979, followed by Reagan's in the USA, heralded the return of pre-Keynesian economic and social conservatism. In Britain, the fierce monetary and fiscal squeeze that ensued put manufacturing to the sword, while the abolition of exchange controls allowed the burgeoning wealth from North Sea oil to be invested largely abroad. Subsequently, while the Third World was devastated by the debt crisis of the 1980s, the UK and US financial sectors pressed forward with deregulation at home and expansion abroad, laying the basis for their joint dominance of global financial markets.

Breakneck expansion eventually led, as it always does, to unsustainable credit growth, overheated markets and a new round of inflation. When the bust came in 1990-91, coinciding with the fall of communist regimes across the Soviet bloc, the free-market right once again blamed excessive public spending. The result within the European Union was the strictures of the Maastricht Treaty, first negotiated in 1991

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and finally enacted, after some resistance, in 1993. In relation to public finance, from now on all EU member states were enjoined to limit their fiscal deficits to 3% of GDP, and their aggregate public debts to 60% of GDP. Limits along similar lines had, by then, become a central feature of Third World aid packages from the International Monetary Fund and the World Bank; they were also imposed upon the post-communist 'transition' countries. The hegemony of neoliberalism was now complete.

What is most striking, and highly relevant to the assessment of this week's IFS intervention, is that at no point did the monetarist economists – or their neoliberal successors – explain why any particular limit to public deficits and debt was *economically necessary*. Instead we are offered, then as now, an entirely circular argument. We are told that deficit cuts are necessary because international bond markets require them. So why do international bond markets require them? Because *they* think that cuts are necessary. And why is that? Because the economic experts say so!

Now it is certainly the case that any individual government which accumulates debts that are very high compared to those of other governments will find itself subject to special scrutiny by the bond markets, as the Greeks now know only too well, and as many Third World governments found out already back in the 1980s. We should of course make allowance for the pernicious effects of speculators, for instance the role of George Soros in our own 1992 crisis that forced us out of the EU's Exchange Rate Mechanism, or the flight of hot money from East Asia in 1997. But a reasonable case

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can still be made that governments should, in normal times, avoid excessive reliance on borrowing, especially to fund current expenditure as opposed to capital investments.

However, from the standpoint of macroeconomic stability, and especially that of maintaining full or near-full employment, our overriding concern today should remain that of Keynes: the need for governments to sustain economic activity at a time when savings in the private sector greatly exceed investments. This need is met by absorbing excess savings through the sale of government securities, the proceeds of which are then spent.

And because we now live in an integrated global economy, this Keynesian precept should be applied at the global level, not at the level of an individual country. Thus, the continued growth and prosperity of countries with chronic trade surpluses, like Germany and China, depends in conditions of global recession on the willingness of other countries like the USA and Britain to continue to run trade deficits. As a corollary – and this is *really* an economic fact – there will be matching outflows of capital from the former countries, and inflows into the latter. Given the current reluctance of businesses and households in the trade-deficit countries to borrow and spend, it is their *government* borrowing that keeps the world economy going.

We can see, therefore, that the International Monetary Fund, the Bank of England, and Chancellor Darling and Shadow Chancellor Cable, are right to urge that

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government deficits should not be cut prematurely, because that would risk a 'double-dip' recession. As long as global savings continue to exceed global private sector investments, governments must continue to absorb that excess.

But still, why this obsession with restoring the deficit and debt ratios to 'normal' levels, once the global recovery has reached the point where private sector investment has recovered fully and cyclical unemployment has disappeared? There is, after all, no economic 'law' that dictates the 3% and 60% levels, or any other numerical values. The level of aggregate economic activity is entirely unaffected by the proportion of demand that flows through the public rather than the private sector.

The answer to this question, now as in the 1970s, lies not in economics, but in politics, or more specifically, in class warfare. It concerns the privileged position of private wealth within our restricted form of democracy. After 1945 the propertyless in most parts of the world, West, East and South, made remarkable gains in their well-being and in the strength of their political voice. By the mid-1970s, the propertied classes, whether capitalists, usurers, merchants or landlords, or indeed the Soviet-bloc bureaucratic élite, found themselves on the defensive on many fronts.

Many radical nationalist governments in the Third World continue to press for reforms in the governance of the world economy, challenging the new forms of economic colonialism that followed independence. In the Soviet bloc, the Prague Spring and the first stirrings of the Polish workers' movement threatened the

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bureaucrats' highly crentralised power. And in the West, not only had new social movements challenged the elites on issues of gender, race and the environment, but workers were also advancing new claims to workplace democracy and economic security that seriously threatened the power of big business and high finance.

The neoliberal counter-revolution was the concerted response. For more than thirty years, the ideologists of neoliberalism, with economists to the fore, worked assiduously to construct a new common-sense about the economy based on the old liberal mantra: property rights, individualism and the residual state. By the time the sequence of localised crises that began in Britain on Black Wednesday in 1992 culminated in the global credit crunch of 2007, that work of construction was very largely complete.

Faced in September 2008 by an imminent total meltdown of global finance, the business and financial élites had no choice but to sanction a massive and collective rescue programme by the governments of the leading economies. There followed a period during which neoliberalism appeared to be in disarray, and in both academia and the media, alternative voices could once again be heard.

But within about six months, the neoliberals had regrouped. In Britain, as the debate over Darling's 2009 Budget already showed, their ownership of the economic common sense allowed them to steadily shift the focus of debate from exacting retribution and repayment from the banks, to blaming governments for assuming the

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vast fiscal deficits that have kept capitalism afloat. Meanwhile, those who spoke up for real alternatives – for Green New Deals, for radical reform of the banks, for a new international financial architecture – have been pushed back to the margins of public attention. All that matters now, apparently, is to make sure that the state is cut back.

And to make absolutely sure that this happens, the IFS message comes with a chorus of attacks on the competence, work effort and dignity of public sector employees. The accompanying relentless demands for 'efficiency gains' have a double purpose. On the one hand, they are a euphemism for cuts in public sector jobs and pay, heralding an assault on the last redoubts of organised labour while undermining continued citizen support for nurses, teachers and soldiers alike. On the other hand, they undermine our confidence in the provision of public goods, encouraging a resumption of the shift to private sector providers initiated under Mrs Thatcher.

Given these attacks on working people and their communities, it is surely time to summon up our collective courage and reject the lies and misrepresentations that are being foisted upon us in this phoniest of all elections. For at present, it really doesn't matter what combination of Libs, Labs and Cons cobble together a majority at Westminster. The Institute for Fiscal Studies are sadly right about one thing: the government that emerges will impose massive cuts in public spending. But they are not, repeat not, economically necessary.

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Or perhaps, it's time for all of us to stand up with Howard Beale in the film *Network* and say with one voice: "I'm as mad as hell, and I'm not going to take this any more!".

h.k.radice@leeds.ac.uk

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Hugo Radice is a Life Fellow of the School of Politics and International Studies, University of Leeds. His recent columns on the crisis in the Yorkshire Post are available via his webpage, http://www.polis.leeds.ac.uk/about/staff/radice.

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