How necessary was British austerity in 2010?

George Osbourne deemed it paramount to reduce Britain's accruing budget deficit when taking on the equally challenging role of Chancellor of the Exchequer. He declared in a 2010 speech that dealing with the budget deficit he inherited was the 'single greatest economic challenge the new Government faces' (GOV.UK 2010). Yet circumstances were out of the ordinary; the world was feeling the effects of the 2008 Global Financial Crisis on an unprecedented scale. Britain was at the forefront of this crisis, both cause and effect, meaning a substantial shift in economic policy was required. The Conservative Party opted for austerity. This was evidently a contentious issue as people questioned its economic efficacy and the iniquity of the timing post-financial crisis.

Given Phillip Hammond recently declared austerity was coming to an end (The Economist 2018) it is difficult to discuss the full impact of austerity when it has not been carried out to its full extent. Yet according to the Financial Times (Giles 2018), austerity and a relatively stronger period of growth have restored public sector net borrowing to the pre-crisis level; in the 12 months prior to March 2018 this figure was around £42.6bn. It could be concluded that up until now Osbourne's economic justification of austerity has been verified by these statistics, yet the issue is more complex because austerity has ramifications beyond deficit reduction. The question lies in how necessary austerity was to achieve this goal at this time. It is an economic truth that debt is a real phenomenon and must be dealt with on a macro level as unfailingly as it is on a micro level, but whether austerity in the context of 2010 was the necessary means to do this is worth exploring. I will argue that austerity was not an economically appropriate policy for the time period in question, its motive was correct but its execution was not feasible for that particular time. I will argue this through an economic and social lens as well as exploring the role of Conservative party ideology and their use of statecraft.

Defining Austerity

Austerity by its very nature is a nebulous concept. Wren-Lewis (2016) believes austerity is an outcome that occurs through fiscal consolidation; it occurs when there is a noticeable increase in involuntary unemployment. I take an alternative view of austerity as a combination of both the intended outcome and the policy action of trying to achieve a deficit reduction and subsequent debt reduction. It is worth noting the malleability of the austerity process as a product of the times. Tomlinson (1998) includes in his definition of 1940s austerity the feature of rationing, which meant personal consumption was given very little governmental priority. This was evidently not a feature of 2010 austerity as it was justified in terms of boosting confidence to spend and invest in the economy. The goal of austerity is more straightforward with the intention being to achieve a reduction in a government's budget deficit which in time will pass onto debt reduction, yet the circumstances in which this should occur and the means of achieving this are heavily contested. Since the 2010 austerity there has been a change of Government leadership and a change of agenda as a consequence of the EU referendum result. For this reason I will focus on austerity during Cameron's term from 2010 to 2015. In the context of the post-financial crisis response much has been debated and written about the pertinence of austerity for this time period (Gamble 2014). Much of the argument surrounding austerity is based on the argument of when it is appropriate or effective to use it. In Britain there was a gentle economic recovery in 2013 and 2014, meaning the debate is whether this was a result of sustained austerity or a consequence of a de facto end to austerity by the Conservatives before this (The Economist 2015).

Economic necessity

John Maynard Keynes wrote in 1937 that 'the boom, not the slump was the right time for austerity at the Treasury' (Jordà and Taylor 2016). The economics of this statement has since been contested by luminaries of both economics and politics. Balancing the books is an economic necessity for any government and yet escalating debt has been a centuries-old problem for western countries. As Piketty (2014) notes, although todays debt in Britain is not close to its 19th century levels it still invokes as much economic perplexity as it did then. Within the context of the Conservative's economic policy implemented in 2010 it appears the economic necessity of austerity was not as apparent as was portrayed by Osbourne and Cameron.

The problem of Britain's Government debt cannot be pushed to one side and needs to be addressed before it perpetuates out of control. Yet the means of achieving this isn't exclusively through the contentious policy implemented in 2010. Stiglitz (2017) has dissected the recent batch of western austerity as essentially getting the policy the wrong way round; instead of austerity leading on to growth, the target should be growth and stimulating the economy that can then instigate a reduction of government debt. Stiglitz expresses the fact that too often the focus of policymakers is often on the debt numerator of the debt-GDP ratio rather than increasing the GDP denominator. An argument against this may be that the absolute value of debt will still rise as a consequence, yet by increasing their GDP a country is in a better economic position to pay it back. This corresponds with Jordà and Taylor's (2016) findings that fiscal constraint 'generates a drag on growth' (pg.220), and this drag is more pronounced during a slump than a boom.

This notion that the economic conditions of Britain did not require austerity is also echoed by Paul Krugman (2015) who advocates the historical precedent that austerity should be used in a time when an economy is unsustainably booming into high inflation or is in a post-war environment, therefore this batch of austerity was merely experimental (I will later explore Britain's post-war austerity). Britain had significantly lower interest rates than their European counterparts such as Greece, as a result Krugman maintains that this is indicative of a country saturated with stubborn savings and thus requires deficit spending to stimulate the economy. British debt was also radically different to its eurozone neighbours in that its debt was funded through longer term bonds with low and locked-in interest rates (Gamble 2014). Eurozone strugglers such as Greece had debt funded in short-term bonds with ever increasing interest rates when payment failed. The fact that the British Government could borrow at extremely low interest rates meant short-term deficit spending may not be as harmful as perceived. Of course the deficit has to show signs of shrinking in the near future before Britain's credit rating is questioned. Britain did in fact lose its top credit rating in 2013 (BBC News 2013). Yet there is a short-term trade-off in a recession and it seems logical to recover the economy, or at least start a recovery, before basing your economic agenda around deficit and debt reduction. As I will later explain, there was a perception that debt reduction was more imperative than it was in reality, largely due to the use of political statecraft by the Conservatives.

A study by Alesina and Ardagna (2010) indicates a contrarian position to Krugman and Stiglitz as their results show that ‘fiscal stimuli based on tax cuts are much more likely to be growth enhancing than those on the spending side’ (pg.62). This is based on the belief that cuts create confidence. Reinhart and Rogoff (2010) shows that debt above the threshold of 90% is associated with lower growth rates. The UK’s debt rose close to this figure in 2012; according to Krugman (2015) austerity was only truly implemented by Osbourne and Cameron for two years after they were brought into power. The post-crisis growth of debt did begin to slow after 2012, which may well be due to this period of austerity but it is a tenuous link to be made when it had only been in operation for such a short period of time. There is a causation-correlation dilemma as well as the problem that austerity impedes growth. Jordà and Taylor (2016) quantify the slowdown in growth due to austerity to be around 3.1% of GDP by 2013. Echoing Stiglitz, a focus on economic growth during a recession should be prioritised over austerity. Recovering the economy through economic growth can then provide an environment for austerity. This means that austerity was not an economic necessity in 2010. Also the nature of cuts, as I will explain later, were not indicative of a government fully committed to austerity. It was important that Osbourne put the mounting debt issue on the economic agenda for his successor Phillip Hammond to pick up on. However this is different from saying austerity was necessary when it was introduced. There is substantial belief that alternative economic policy can help reduce public debt in the longer term. This is particularly sensitive during a recession, as spending cuts are often implemented to reduce net government spending. Despite being right about the need to reduce the public debt, a fiscal-led recovery was needed before austerity should be implemented, as Keynes had maintained decades ago.

<u>Social necessity</u>

Blyth (2013) highlights the social conflict at the epicentre of the austerity debate: the poorest in society will be more affected than those towards the top of the income distribution as they are more reliant on government-provided services. Therefore after a financial crisis, that did not stem from the poorest in society, it would not be inappropriate to highlight the iniquitous nature of austerity under such circumstances. The aftermath of the financial crisis had a profound effect on the poorest in society. Having concluded that it was not essential for Britain to implement austerity from an economic point of view, it is worth exploring the social necessity which helps explain this economic standpoint, and whether it made the recession worse for those individuals.

The timing of austerity is paramount for exploring austerity from a societal perspective. A useful point of comparison is the British austerity introduced after World War Two. A war is a unique scenario for a country to find itself in, and austerity fits quite naturally into post-war economic policy. As Reinhart and Rogoff (2010) indicate, post-war government debt is usually a consequence of war itself meaning it naturally begins to slow when peace ensues. Post-war growth also has a tendency to be high without much need for government injection meaning austerity can occur in conjunction with this. National debt was over 200% of GDP by the end of the war and this figure gradually fell over the following years (Alesina and Ardagna 2010). The initial austerity of Atlee's Government wasn't without its social implications as rationing became even more intense than during wartime (Zweiniger-Bargielowska 1994). In 1948 consumer spending did however return to the pre-war level. Austerity during this period was formed around the construction of a new welfare state with the NHS the most expensive innovation (Tomlinson 1998). 2010 austerity instead saw extensive cuts to this welfare state. It is clear that the social policy of both the 1940s austerity and 2010 austerity were radically different as well as the external context in terms of post-war versus post-financial-crisis. Spending during wars is so excessive that the aftermath allows an increase in non-military spending whilst overall government spending falls (Clark and Dilnot 2002). The influence of a natural decrease in military spending allowed the Labour party's austerity to coincide with the foundation of a new welfare state with the NHS a flagship of healing a wounded Britain. The 2010 austerity feels more austere by consequence as there was very little relief; there was no carrot for the stick of austerity.

Osbourne's immediate economic plan saw a shift towards fiscal restraint which clearly had an impact on the poorest in society. In June 2010 it was announced VAT was rising from 17.5% to 20% as well as the freezing of child benefit and public sector pay as part of a 25% cut in spending on public services (BBC News 2010). As mentioned earlier, many of these changes clearly impact the poor to a greater extent; VAT is considered a regressive tax for example, as poorer households spend a higher proportion of their income in the economy. Hills and Stewart (2016) explore the socioeconomic inequalities that stemmed from the financial crisis and subsequent austerity. They are surprised to find that income inequality remained fairly flat between 2012/13 and 2013/14 even though household earnings did fall to a greater extent for the poorest percentile between 2007/08 and 2013/14. The biggest 'pay squeeze' (pg.263) was for the poorest in the working population, who were not largely employed in the financial sector of the UK. While most in the finance industry could do little about the crisis, those outside the industry whose wages or employment status suffered as a knock-on effect could be rightly aggrieved about the situation. Given austerity impacts the poorest to the greatest extent it seems unfair then that those same people should, on average, be dealt a further economic blow beyond their control. It also seems paradoxical when implementing austerity, that the Government reduced the top income tax rate from 50% to 45% in 2013/14 whilst introducing reforms such as freezing Child Benefits (a real terms cut) for 3 years from 2011/12 (Hills, De Agostini and Sutherland 2016). Then, during the 2015 budget, meaningful welfare cuts (including to tax credits) were announced to further reduce the deficit (Griffiths 2016). If a Government was committed to austerity then there would be exclusively a narrative of making cuts or raising taxes, but cutting income tax for the top rate represents a contradiction of austerity when the desired results had not yet been achieved.

Hills and Stewart (2016) conclude that the social security system largely fulfilled its function: keeping citizens out of poverty. However in the four years leading up to 2013/14 homelessness in London rose by 64% (Teixeira 2015). This rise of homelessness around the country primarily derived from the private rented sector. As Teixeira asserts there is a structural problem of a lack of housing in the UK; it is likely that a rise of homelessness would have been less severe without austerity as short term housing is something that can be addressed, if not to the fullest extent as there are deeper-rooted issues of homelessness beyond housing and austerity. The surprising conclusions reached by Hills and Stewart of relative social stability were likely to be more pronounced in favour of citizens if a post-recession fiscal expansion had been implemented, as Jorda and Taylor's (2016) growth analysis showed. On top of this, the use of contradictory economic policies shows an ambiguity over defining cuts during austerity. Consequently it cannot have been a necessity for austerity to be implemented when the Conservative's policy did not reflect a full commitment to the desired outcome.

Austerity in its latest form has clearly had a profound impact not just on the poorest in Britain but on many of those further up the economic hierarchy. As a general rule of thumb businesses tend to like a smaller government with less spending on social insurance (Stiglitz 2017). Of course this is a rather generalizing statement and largely refers to big businesses, yet it is these big businesses (not all of them) that hold a great deal of political influence in Britain. They also hold a great deal of economic influence. Farnsworth (2015) quotes a figure of £93bn that constitutes the most direct forms of corporate welfare. These statistics on corporate welfare are difficult to analyse, as Farnsworth admits, given it is difficult to quantify the extent to which the benefits to businesses are then passed on to the wider economy and consumers. But it is not appropriate to view "corporate tax benefits" (the largest section of corporate welfare) as subsidies to profits unless it is believed that the benefits-induced investment would occur without the capital allowances, which is unlikely (Wilkes 2015). The £93bn figure is more complex than is perceived on the surface as the benefits can be ubiquitous but also can in some circumstances benefit the firm more than society at large. The complexity of the issue may be why it isn't frequently discussed. The more contested issue is for the big multinational firms who, through use of legal loopholes, seem to pay less than their fair share of taxes at a time of economic depravity for a growing number of people in the UK. Amazon, Google and Starbucks have all come under post-recession scrutiny for their relatively diminutive tax receipts (The Economist 2012).

In terms of addressing this in light of the necessity of austerity, it is clear a clamp down on use of tax havens and the subsequent increase in corporate tax revenues (provided they remain operating in the country) will ease the pressure on the necessity for austerity. This also exemplifies the ambiguity over the nature of austerity and how the desired outcome is achieved. It is unsurprising that those citizens feeling the effects of welfare reforms are disillusioned with the concept of austerity when there are reputable corporations at the centre of tax avoidance reports. To be equitable about austerity the Government shouldn't feel the need to raise corporation tax, as this plays a key role in investment and stimulating confidence in an economy, but instead make sure those that should be paying tax are paying tax.

The use of Statecraft

It is also worth exploring the political influence on the decision to implement austerity and the extent to which this undermines the necessity of it. Both coalition parties were quick to pass the blame of the recession onto the Labour party's poor management of the economy, including the public finances (Gamble 2014). This was a noticeable use of statecraft from the Conservatives. It is expedient, but not uncommon, for a party to come into power and immediately pin the blame for Britain's problems on the previous government. In the case of austerity, as mentioned, it was justified on the grounds that it was clearing up the Labour party's mess.

There was also effective use of intra-coalitional statecraft by the Conservatives in gaining dominance of the policy agenda over the Liberal Democrats. The promotion of deficit reduction by Osbourne and Cameron as the highest priority for the Government was the way to ensure this (Hayton 2013). As Hayton advocates, the period of 2010-2013 was an example of largely successful statecraft from the Conservatives. As well as dominating the coalitional relationship, the Labour party was on the receiving end of an economic reprimand from the Conservatives with the aim of reducing citizens trust in the party to manage the economy. Cuts became synonymous with economic and political competence. As previously concluded austerity was not an economic necessity, but through diligent statecraft the conservatives created the appearance that it was. It is still important to not exclusively focus on statecraft as the cause of austerity. The neoliberal thinkers that emerged in the latter half of the 20th century, such as Hayek, conveyed the idea that austerity was an appropriate response to economic turmoil and therefore must be considered (Griffiths 2016). It is difficult to quantify the impact this role might have played in the post-crisis austerity but given how pervasive austerity was throughout Europe it would appear the economic doctrine that dominated the late 20th century had influenced the economic response to the crisis. It is undoubted that there was genuine belief that the neoliberal approach to recession would work to reduce the deficit, and the evidence suggests it did work to some extent. Yet this doesn't bypass the deliberate use of statecraft from the Conservative party which operated alongside the neoliberal paradigm.

The timing of austerity is crucial for looking at its necessity. The imminence with which it dominated the Government's agenda was unusual given the aftermath of the financial crisis was still in full flow by 2010. If a Government considers complete reduction of debt essential within the not too distant in the future then aggressive austerity will be necessary to achieve that end goal. But it is important to associate necessity with economic and social pragmatism. It was an excellent use of statecraft creating the mirage of deficit reduction being an unavoidable duty for the Government, to which the blame for this false reality could be heaped on the Labour party. While it is true the Government needed to be wary of its deficit in order to tackle its mounting debt, the means to achieve this goal, as mentioned, did have an underlying political motive. This was to the detriment of a large proportion of society. Blyth (2013) labels it a dangerous misperception that austerity is the result of too much spending leading to a state-led debt crisis. Blyth maintains this was only the case in Greece consequently meaning the same narrative that was presented about Britain was a falsity. Krugman (2012) goes as far as to say the austerity programme was about creating panic around the deficit in order to disintegrate social programmes. This seems too aggressive an approach to take, as there was certainly an element of the Conservative party highlighting something that needed to be fixed, and more importantly identified the debt problem as something that could be fixed. Yet this ideology was in conjunction with competent statecraft that tarnished people's trust in Labour and led to outright command of the coalitional partnership. This clearly was an effective ploy as the Conservatives won a majority in 2015, albeit a slim one. A rather sad conclusion to be drawn from this is that sometimes what is in the best interest for the incumbent is not always in the best interest of the country. What may have appeared a necessary use of Machiavellianism by the Conservatives was not necessary to the country at large, which is what this essay is concerned with.

Conclusion

In this essay I have shown that austerity in the aftermath of the financial crisis was not necessary for Britain from both a social and economic standpoint. Whilst the Conservatives may have publicly deemed it necessary, one could be forgiven in thinking that a large part of that was effective statecraft. Austerity was more an intelligent play by the Conservatives rather than an unavoidable reality for the country guided by economic ideology. Further study could delve further into the individual social issues such as employment, health and education but I have instead attempted to present the general atmosphere of the time, particularly for the poorest in society. My economic stance has followed that of true Keynesianism in that there is a time for austerity and a time for fiscal expansion. Clearly a country cannot hope to sustain itself on debt but it must address this at the right moment in time, in the UK post-crisis it was a case of right place wrong time.

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