Fire Brigades Union

Investing in the future

A different way out of the economic crisis

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THE CUTS: A CRUEL DECEIT

In October 2010 George Osborne announced cuts in public spending of £80 billion, averaging 19% over all departments, over the next four years. These are the most savage cuts in 50 years. They fall on services needed by all British people: half a million public sector jobs face the axe.

The axe falls on the poor. An average family at the bottom fifth of the income scale will lose three times more as a proportion of its income (£7 out of £200 per week) than one at the top.[1] Meanwhile, prices rise while wages are flat or falling. The government is directly responsible for the increases caused by raising VAT and indirectly for many more, letting rail and bus companies and utilities raise prices far above inflation.[2]

The axe falls on the deprived. The BBC found that in Hackney, one of the poorest boroughs in London, every adult will lose £210 per year whilst in wealthy East Dorset each adult will sacrifice a life-threatening £2.86.[3]

The axe falls on the vulnerable. Pension contributions will rise by 3% while payouts are slashed in real terms by 20% or more, by being tied to the consumer price index rather than the higher retail price index.

The axe falls on the sick. The NHS has not been 'ring fenced'. It must make 'savings' of up to £20bn over the next four years, whilst its real costs will rise by 4% a year because of rising population, ageing, and new technology.

Meanwhile subsidies and kickbacks to the private sector are untouched, and the government even cut taxes on companies and the rich by £13bn in its June Budget.

These cuts use the flawed economic reasoning which created the crisis:

(1) They fail to address the principal cause of the deficit which is the loss of *output* caused by the slump. The government's measures further reduce output, and will lead to lower tax revenues and even more cuts.

(2) They will increase inequality, the real cause of wasteful benefit costs, above all housing benefits whose direct cause is the shortage of 1,600,000 houses and the costs of keeping 2,500,000 people out of work.

(3) They will deepen the structural economic problems which led to the crisis

(4) They fail to control the banks, whose conduct produced the world crisis. The bailouts have incurred net debts of £1,434bn and the interest on those debts has amounted to £54bn to December 2010.[4]

(5) They will maintain a labyrinth of kickbacks and tax breaks which hide the true cost of the private sector and reward it for speculation, not investment.

(6) Above all, they fail to address the underlying long-term obstacle to growth in the UK economy: the collapse of private investment

What is required is a programme of *growth,* organized so the public reaps the returns. This calls for public investment in *advanced creative, sustainable and productive services* which are shaping the twenty-first century economy. It requires investment in *equality* to reduce the costs of welfare and ensure that those who benefit from Britain's wealth, contribute equitably to the sources of that wealth. And it requires investment in the *future,* replacing the broken society of greed with new human values of respect, equality, care and sustainability.

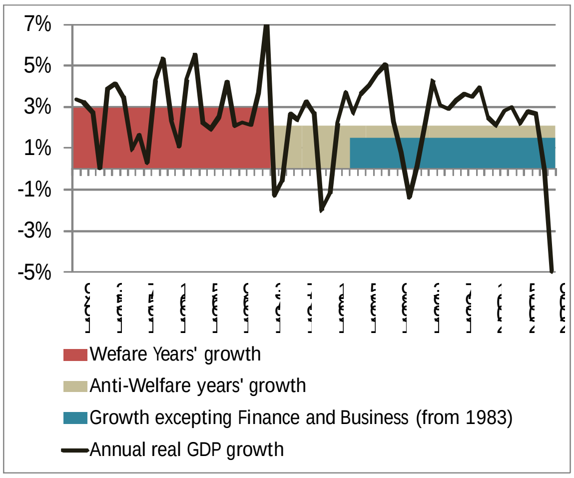
We propose an emergency programme of public investment to:

(1) Create 1 million new local authority- owned homes by 2020
(2) Create 1 million new climate change jobs by 2015
(3) Rebuild city commuter systems under public control to provide a viable alternative to car-based urban transport by 2025
(4) Raise education in education to top world standards, creating a labour force that can rebuild the country, and universal, free, tertiary education by 2030
(5) Restore public services, reverse cuts to benefits and the NHS, slash inequality and create a 21st century society founded on care instead of greed

These proposals, we show, will *reduce* the deficit instead of expanding it, by focusing on the missing dimension of the government's proposals – *growth*.

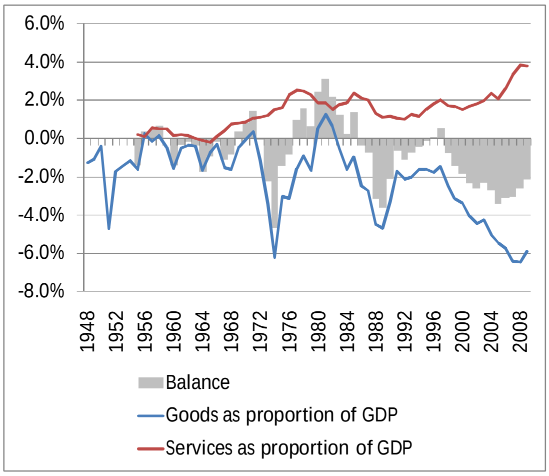
THE WORST SLUMP FOR 80 YEARS

CHART 1 UK LONG-TERM GROWTH



Source: ONS National Economic Accounts

CHART 2 UK BALANCE OF PAYMENTS



Source: ONS pink book

The real cause of the deficit is not excessive government spending but an economic crisis. It is the policies that led to this slump – and the particularly deep effect it had on the UK economy compared with other countries – that must be addressed.

From the second quarter of 2007 to the third quarter of 2009, the output of the British economy fell from £308 billion to £288 billion, a fall of 6.5% in just over two years. Output has yet to recover to its pre-crisis levels, and fell again at the end of 2010 - so the slump has lasted at least four years. It is now widely forecast that employment will not recover for a decade.

There is no clear sign it is over yet. Former Chancellor Alastair Darling called it the biggest economic crisis in over 60 years.[5] Actually, he should have said 80 years: 60 years ago, after a five-year programme of postwar government spending on a scale since undreamed of, the economy was steaming into twenty years of growth.

The British crisis was neither inevitable nor beyond our control. Many countries grew while Britain collapsed. Even among those countries that were hit, the British economy did particularly badly.

This was because of accumulated structural problems arising from 35 years of misconceived and wrong policies that must now be reversed, to set Britain on the path to a stable, long-term, sustainable recovery.

The facts speak for themselves. Britain has a stagnant economy; it has fallen from 3rd largest in 1950 to 6th. As chart 1 shows, between the 'welfare years' of 1948 and 1974, real GDP growth averaged 3% and never fell below 2% in any five years. During the 'anti-welfare' years since 1974 with public services relentlessly targetted, growth averaged 2.1 %, and was ever more unstable, with four two-year periods of sub-zero growth leading to the present crisis, unprecedented since the 1930s.

Britain has an unstable economy. After thirty years of uninterrupted positive growth which followed the war, there have been four successive deep crises, the latest being the deepest since 1929.

Britain has an unsustainable economy. As chart 2 shows, the balance of trade has been structurally in deficit since 1974. Moreover its recovery under Thatcher was due to the one-off bonus of North Sea Oil. And since 1996, when the banking sector took off, it has remained stubbornly negative.

BONUSES AND BENEFITS

The government claims it will recover £7bn in reduced benefit fraud. But by its own estimate, it only loses £1bn in wrongful claims.

Coincidentally, this year, £7bn is to be paid out in bonuses to top executives in Britain's banks, including the state-owned ones. The new RBS CEO, Stephen Hester is to get £8m in compensation, including £1.2m in cash. This is more than his disgraced predecessor Goodwin, who was on £3.5m. But RBS made it up to Goodwin – who took away a pension package totalling £17 million. RBS has cut 7000 jobs. Stephen Hester told the Treasury select committee that even though it was state-owned (87%), RBS had to pay out bonuses because "it was the prisoner of the market".

Britain has an unbalanced economy – though not as the chancellor maintains, because of the public sector. Finance and business services are now over a third of the economy. Genuine business services which sell a real product – like software, accountancy or legal services – are needed, but the rest of the economy is growing at an average of only 1.5%. An economy in which two-thirds grows at half the rate of the other one-third is not sustainable – most of all when even that growth depends on financial speculation.

Britain has a vulnerable economy. It depends on the financial markets which created the crisis, starting when international markets deserted productive investment for the fictitious 'assets' which Warren Buffet rightly labelled 'weapons of financial mass destruction'.

To re-balance the economy, and set it on a path to stable growth, this out-of-control industry must be brought under control and the public money which has been poured into it must be put to proper use rebuilding the economy.

Instead of making working people and their families pay for the crisis, public investment should be expanded, not cut, while those who caused the crisis should pay to clear it up.

"We are now in for a 'sober decade' after years of 'excess' and we are all going to have to save more and spend less".
- *Mervyn King, governor of the Bank of England, October 2010.*

Britain's public sector deficit is a symptom of the economic crisis, not its cause. Over time, both government income (mainly tax revenues) and government spending tend to rise as the economy grows.[6]

CHART 3: DIFFERENCE BETWEEN UK SPENDING AND INCOME

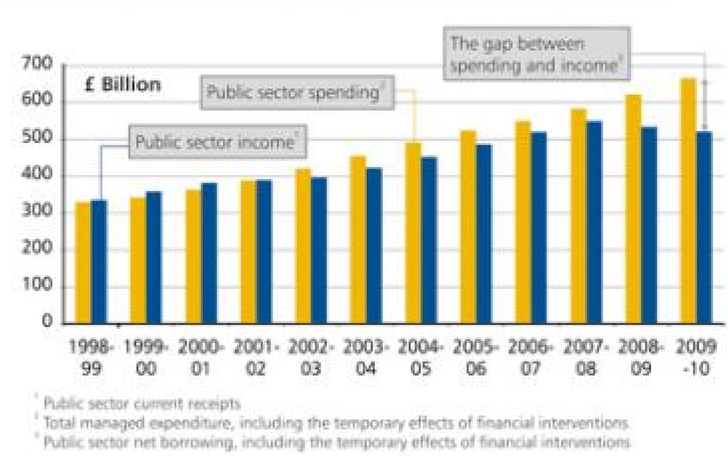
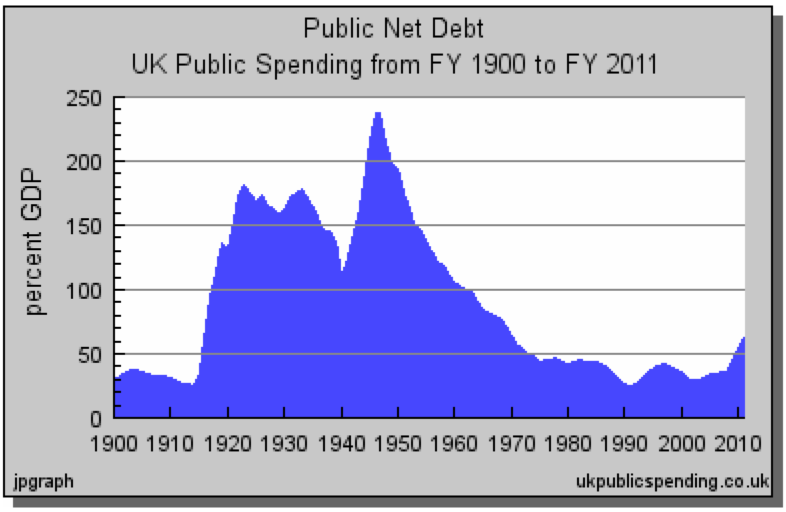


Chart 3 clearly shows the real source of the problem. Neither Britain's public sector annual deficit nor the overall debt level is extreme, and neither have been growing excessively. *Revenue* has collapsed. This, in turn, is because of the crisis. Consequently, the way to address the crisis is to restore revenue. This needs *public investment*.

The public sector deficit is not exceptional. Back in 1991, John Major racked up a budget deficit of 6.3% of GDP, pretty much the same as last year's 7% – yet this Great Recession has been nearly three times as severe as that in the early 1990s.[7]

CHART 4: UK PUBLIC NET DEBT AS % OF GDP



Last year, Britain's non-bank debt was £890bn, equivalent to 61.8% of GDP. (the bank are much larger - £1,434bn). Hon-bank debt is not high by international standards. Germany and Spain are the only major EU economies with a lower debt stock than Britain. And as chart 4 shows, historically the debt is low.

For the entire period 1916-1971, public sector debt as a share of GDP was higher. In 1947, it was nearly four times what it is now, at nearly 250% of GDP. The post-war Labour government did not cut public spending: it launched huge investments in housing and infrastructure and created the welfare state. This created growth – and the deficit halved in 10 years.

The deficit only started rising when the recession began in 2008. Before that, spending rose slower than revenues (5.5% versus 6%) and the deficit narrowed. Spending is now only £3.1bn above that trend mainly because rising unemployment has pushed up welfare payments. The real problem is lost revenue from taxes, which would have raised £103bn more without the recession –two-thirds of the entire 2010-2011 deficit of £155bn.

2010's limited growth had already reduced the deficit before the coalition's cuts begin to bite: in 2009 the Treasury forecast a 2010 deficit of £178bn which is now expected to touch £140bn for the financial year ending next March. [8]

Historical evidence not only shows that growth will reduce the deficit and the debt, but that cuts only make it wider. After Margaret Thatcher's similar savage policies from 1979-86, the deficit rose as a proportion of GDP for the next seven years.

Official analyses confirm this. The Treasury reckons that for every £1 increase in output, 75p will return to the government in the form of higher tax revenues and lower welfare payments.[9]

How to Fund Investment

It is claimed that the deficit must be reduced because otherwise Britain will share the fate of Greece or Ireland and be shut out of international debt markets. This is plain wrong. The Athens and Dublin governments *did* cut public spending ferociously, and their economies went into a tailspin. Not only did this send their deficits higher but *increased* their borrowing problems. No sane investor will put money into a failing economy except to get out quick after making a killing.

The British government borrows long-term funds in international markets at average interest rates of around 4%. This is well below the likely returns on new council housing or transport projects. What investors require is confidence that their money will be returned – which state investment can guarantee.

British taxpayers now own a large swathe of the banking sector after its bailout. This is a great opportunity to turn it into a public service that provides funds at reasonable rates for infrastructure and construction projects, loans to small businesses to keep them going and to households to meet their big ticket needs.

The banks are awash with cash, as they continue to hoard money. State-controlled banks like RBS and Lloyds should be instructed to use this to invest in the key areas required, housing, transport, infrastructure and education. In addition to producing a growth-led deficit reduction, the positive returns on the investment would provide the funds for further investment. Instead, the Tory-led government is pledged to return these banks to the private sector at the earliest opportunity.

The government has made no serious inroads at all on the system of subsidies and kickbacks to the private sector which reward it for failure and penalize it when it invests in efficiency – like the £36 billion in tax breaks it gives to private pension funds, £100 billion it loses in tax avoidance and evasion, the £54 billion it plans to shovel into the broken privatized railway system or the £7 billion in bonuses which the banking sector paid itself last year. Mobilising these resources will pay for public investment and restore growth: the real key to long-term commitment from both UK savers and foreign investors.

HOUSING, TRANSPORT, INFRASTRUCTURE & EDUCATION

CHART 4: COMPLETED DWELLING CONSTRUCTION 1949-2009

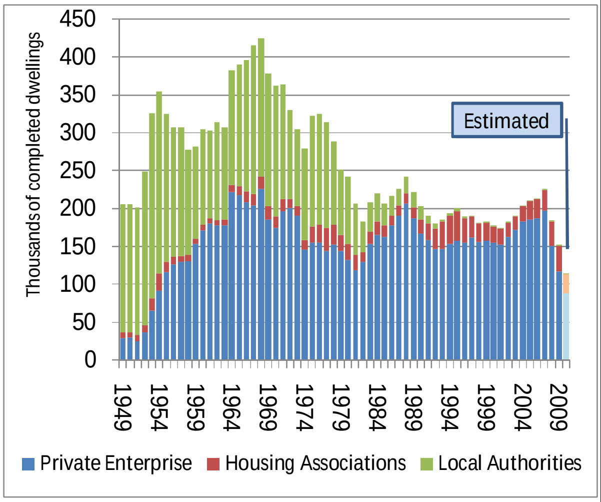
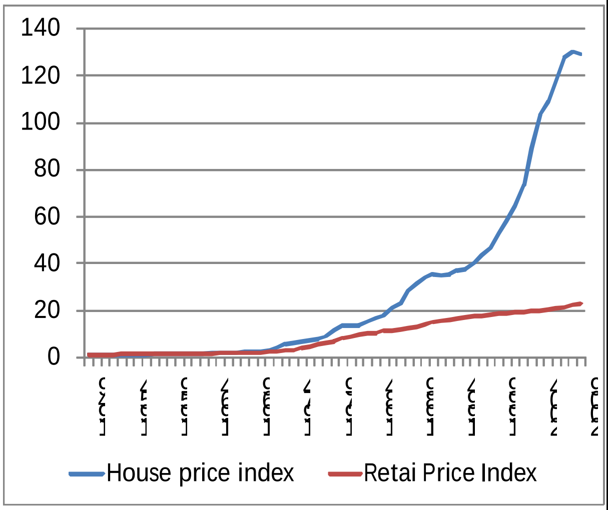


CHART 5 HOUSE AND RETAIL PRICES SINCE THE WAR



Public services are broken because private finance has failed them. At the core of this failure is a twin crisis of *housing* and *transport* which has become a national catastrophe, at the heart of all the country's most pressing social and economic problems.

The shortfall in housing, on the government's own figures, now stands at 1,600,000. At the same time, as chart 4 shows, fewer houses are being built than at any time since the war. It is the *private sector* which is responsible for the failure, with less completions in 2009 than in any year since 1956.

Instead of building houses, the property industry has retreated into speculation as prices spiral. At the same time the social costs have multiplied: rising housing benefit which are entirely due to rising housing costs, the highest inequality in the OECD, intolerable congestion.

The first step in reconstructing Britain's public services is an emergency programme of public investment in housing and transport of £100bn. This will pay for itself in ten years and will create 2.5 million jobs. It will replace the extravagant inefficiency of the private sector and PFI, which was so bad it forced even Stephen Byers and Boris Johnson to renationalise Railtrack and Metronet.

It will also cut benefit costs by reducing *living costs,* above all housing costs and reducing unemployment; and it will slash social costs like crime and ill-health. Expanding public services, contrary to the government's claim, is the only way to cut costs to the taxpayer – by attacking the waste of human resources at its roots.

It will engage Britain's young workforce in the sustainable economy of the future, placing Britain in a pole position through the experience gained by ensuring house and community construction, using advanced sustainable technologies, are at the centre of recovery.

INTO THE 21ST CENTURY: A HIGH-SKILL, HIGH-WAGE SERVICE ECONOMY

CHART 6: PROPORTION OF EMPLOYEES IN THE SERVICE INDUSTRIES IN INDUSTRIALISED COUNTRIES

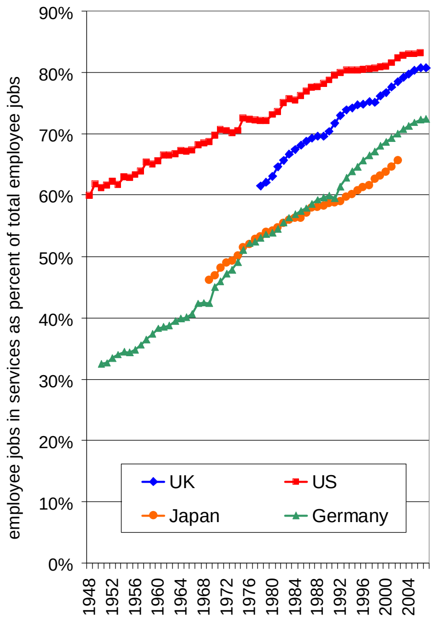
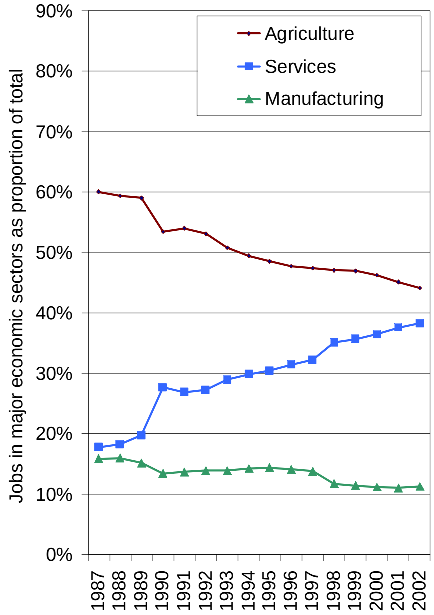


CHART 7: PROPORTION OF EMPLOYEES IN MAJOR SECTORS, CHINA



The government has proclaimed its commitment to a hi-tech creative Britain. But nowhere is its doctrinaire and outdated 20th-century thinking clearer than in the haphazard, incoherent and downright destructive measures it actually proposes, which undermine the key resource Britain requires to make good this commitment – its workforce. What is actually required is

- An educated and informed public that will create a sound domestic market for the cultural and creative products in which Britain already excels
- A diverse and multicultural workforce whose skills and talents will be sought out by the world's leading companies creating a permanent, stable incentive to invest and produce in Britain
- Anchor Research and Higher Education institutions in all major British cities around which the new creative economy can be constructed
- An economy oriented to sustainability as its primary strategic direction of development

This is because of a fundamental change in the economy, shown in charts 6 and 7, to which the government has paid no attention – in which wealth comes from services produced by humans, instead of products produced by machines. Over 70% of workers in the advanced countries are now engaged in *services*. These include both manual occupations like transport, fire services, caring, security, retail or hospitality, and desk-based, high value-added 'knowledge-based' industries at the forefront of modern development, like the creative and sustainable industries, the digital economy, and science-based industry. This includes commercial and legal services which are the real and stable foundation of Britain's transient financial ascendancy.

The skill and creative content of all these is steadily rising. Fire fighters know that productive labour does not come just from wielding machinery. It comes from highly trained workers. Even in traditionally low-paid service trades like retail, hospitality and security, employers experience an ever-increasing demand for an educated, understanding and socially aware staff.

This applies right across the board, to the most traditionally menial jobs. Whether to build the houses of the future, to care for those who live in them, to educate them, transport them, or feed them, we should turn to a socially-conscious, tech-savvy and creative generation who can invent tomorrow's sustainable communities brick by brick.

The government's attacks on education are beyond vindictive: they are pathological. They militate against everything a viable future demands.

UNIVERSAL TERTIARY EDUCATION: A STRATEGIC GOAL

Nowhere is the doctrinaire short-sightedness' of government policy visible than in Higher Education. HE in the UK is now among the most expensive in Europe, and half of all graduates will still be paying off their debts in 30 years. There is no free Higher Education for even the poorest, and students from the bottom 30% of households will pay significantly more.

This is nothing to do with reducing costs. It will save no public money and will to the contrary increase the burden on the public purse:[10] The *only* motive is the government's addiction to a 'market' in education.

The government mistakenly argues that because students get the lions' share of benefits, they should pay the costs. But the first beneficiary of education is the *employer*. Educated workers get higher salaries not out of philanthropic respect for learning but because they create more value. The second beneficiary is the public: we all gain from the enhanced quality of life of an educated country.

The growth in Higher Education in the rest of the world, where this is far better understood, puts the UK to shame – and threatens our future. The answer is a quantum leap. Just as the postwar boom depended on school education, 21st Century society will depend on free and universal tertiary education. The resulting higher salaries will create a Britain that can compete in tomorrow's global economy. According to the OECD, every £1bn invested in higher education in a modern economy increases government finances through higher taxes and lower welfare payments by £3.3bn. Investment in higher education pays for itself.

It makes no sense to charge for a universal service. The fairest mechanism to redistribute private gains is a proper progressive income tax ensuring that those who earn more, put more back into the public purse. This would make a 'graduate tax' unnecessary. The taxpayer will recoup the investment from higher taxes.

INVESTING IN CIVILISATION

The Tories are cutting public spending because it encroaches on private profit, which they wrongly believe will lift the economy out of crisis. This is wrong, because the private sector is not investing. They talk of a 'big society': voluntary agencies, charities and the milk of human kindness. Yet they celebrate 'incentive': huge bonuses, conspicuous consumption, intolerable inequality, and sickening disregard for others. Single mothers, carers, and those who protest to demand a different society, are denounced as irresponsible or dangerous. These ideas cannot live together.

What is required is a society based on *values* – universal entitlements which apply across the board regardless of wealth. Enlarged and democratically controlled public services are the only real way to deliver this. Public provision is needed to secure basic rights: not just political but social and economic rights. This includes:

- Decent, affordable housing for all
- Jobs for all those able to work
- Equality and freedom from discrimination for women, black and ethnic minority communities, and for the disabled: an end to attacks on Muslims
- A universal Living Wage, ensuring employees can raise a family in dignity, instead of just 'surviving' on a minimum wage
- Free medical care at the point of source: end internal markets; dentists and optical fees; price control of pharma; no backdoor privatisation of the NHS
- Decent pensions in the private sector – comparable to the best in the public sector. If private employers cannot match this standard, their employees should have the right to make them enrol in an enhanced public scheme
- Public sector pensions which set a standard for all society

HOW TO MAKE IT HAPPEN.

This pamphlet has advanced a clear and workable alternative to the cuts, and proved the cuts will not solve the crisis. This alternative has always been available and in the past, it has worked. It is working in those countries that do not share the government's doctrinaire and outdated views. Why has it not been adopted now, when it is most urgent? First, because of the mistaken view that the policies we propose are unelectable: and second because of a series of myths, cultivated by those who stand to lose their jealously-guarded privileges if these policies are implemented.

Actually, a huge majority of society wants equality, peace, a sustainable future, education for our kids, care for our loved ones, public services to be proud of, a life that celebrates our many cultures and their arts, dignified old age, and decent wages. Britain's globalised population leans towards these core values. The policies we have outlined can command enormous public support.

What is required is the political leadership to mobilise this support, in opposition to the wealthy and privileged élites whose antiquated outlook shapes the ideas of government. But this outlook has produced a series of myths whose end conclusion is always the same – give money to the people who made the mess. This is a blind alley. To get out of it, the first step is to understand just how wrong these myths are.

The *first* myth is that government debt is too high and must be reduced. We have shown that the level of national debt in the UK is much lower than it was in the 1960s even after this Great Recession and it is lower than most in the OECD. Moreover, it is perfectly financeable.

The *second* myth is that public spending must be cut to get the government deficit down and allow the private sector to expand. We have shown that properly-directed government investment will restore growth, and more than pay for itself. We have also shown that misguidedly reducing government spending will, more likely than not, increase the deficit.

The *third* myth is that Britain is a high tax economy and we cannot raise taxes to pay reduce deficits and debt. British corporations pay the lowest tax rates in the world's top seven economies, while the top fifth of the population have very low tax burdens by international standards. More investment and growth will increase revenues and so would a more equitable tax regime.

The *Fourth* myth is that the government is making all necessary savings to reduce the deficits and the debt. But it maintains a military budget way above what its economy can sustain, paying for nuclear missiles, the war in Afghanistan, and a broken military procurement system. It bails out failed privatisations with a whopping £34bn in tax breaks for private pensions and £54bn into railways whose monopoly providers respond to every funding problem by raising fares. Tuition fees will actually *increase* the drain on the public purse.

The solution is to save money by investing in society: to slash the costs of unemployment, of sky-high house prices and creaking urban transit systems that breed rampant urban poverty side-by-side with uncontrolled abuse of wealth, to return the health service to its core values of preserving and enhancing the well-being of all society instead of the rich few, to provide for an active, dignified and extended old age, and, above all, give employment for all those who want to work, to generate the resources to care for those who genuinely cannot.

This will lay the basis for a long-term transition to a new type of society, based on social values, human wealth, and a sustainable world – a society that believes, and invests, in its future.

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[1] Fairness and Recovery: two verdicts for Mr. Osborne: Stephanie Flanders, BBC News, 20 October 2010

[2] Ref to HEPI xxx

[3] http://www.bbc.co.uk/blogs/thereporters/markeaston/2011/02/fairs_fair.html

[4] ONS, Public Sector Finances, December 2010

[5] 'Economy at 60 year low, says Darling,' The Guardian, August 30 2008

[6] ONS Public sector financial bulletin 18 June 2010

[7] ONS public sector financial bulletin, June 2010 (xxx check AF)

[8] HM Treasury (2010a), Budget 2010, London: The Stationary Office, HC61; also Office for Budget Responsibility (2010), Budget 2010:The economy & public finances– supplementary material

[9] HM Treasury, Public Finances and the Business Cycle, Working Paper No. 5,November 2008

[10] Ref HEPI report