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Time for turning? Why NI needs a fiscal Plan B

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Article appears in Belfast Telegraph Business Month September Edition published 5th September 2011

"To those waiting with bated breath for that favourite media catchphrase, the U-turn, I have only one thing to say: You turn if you want to. The lady's not for turning." Not only was this Margaret Thatcher's most memorable line *(October 1980),* it was a defining policy stance for her premiership. She divides opinion, but Thatcher's determination to stand firm against opposition to her liberalisation of the economy radically re-shaped the UK.

Today, the deficit – currently the largest ever in peacetime ever - is bigger than in 1980, but in many respects, George Osborne finds himself in a not dissimilar position to Thatcher, with clear economic and fiscal parallels.

Like economies elsewhere, and as in 1981, the UK economic recovery has been much weaker than anticipated. As a result, the Chancellor's tax revenues will be lower and borrowing higher than originally envisaged. Against this backdrop, the view that the public expenditure cuts are too deep and too fast has led to a clamour for a fiscal 'U-turn' or 'Plan B'. From the outset, however, it is worth noting that the UK's fiscal plans are much less draconian than those being implemented in other parts of the euro zone periphery – notably the Republic of Ireland. In addition, it is important to note that Plan A also includes raising taxes and clamping down on tax avoidance. The recent UK-Swiss tax deal, potentially netting £5bn initially, is evidence of progress on this front.

Speaking just a few weeks ago, the Chancellor stated that *"the events of the past month are a vindication of the Coalition's decision to get ahead of the curve, and they demonstrate the reckless folly of the alternative route…….The alternative of more spending and yet more borrowing is now frankly ludicrous and places those who advocate it on the outer fringes of the international debate."* This suggests that George Osborne will not change course in a hurry. Indeed, looking at the financial market chaos in the euro zone, the US and more recently Japan *(whose credit rating, like that of the US, has been downgraded due to political inaction on the deficit front),* the UK, by comparison, has been a sea of tranquillity. Sterling has strengthened on the back of this new found 'safe-haven' status.

Clearly, there are compelling economic and financial reasons why Osborne should stick to his guns. At the time of the general election last year, the cost of issuing 10-Year government debt was around 4%. Now, it is 2.5%, a significant reduction of 1.5 percentage points. Conversely, over the same period, the cost of government borrowing within the euro zone *(excluding Germany*) has increased dramatically, increasing debt interest payments and reducing the money available for the delivery of vital public services. For comparison purposes, the cost of raising equivalent debt in other countries is: Greece 18%, Portugal 11%, RoI 9%, Spain and Italy both 5%.

It has been suggested that VAT should be reduced to act as a stimulus. However, VAT is one of the largest revenue generators and cutting VAT is simply not affordable and would lead to a loss of market confidence in the sustainability of the public finances. The same would hold true if the public

expenditure cuts were softened. Arguably, such a scenario would trigger even greater difficulties. The likely chain of events would be: the UK losing its 'Triple A' credit rating; debt interest payments rising significantly; sterling weakening; imported inflation increasing *(notably food & energy);* the MPC having to raise interest rates; the cost of mortgages rising and disposable incomes falling. Clearly, given NI's higher incidence of fuel poverty, lower household incomes and the property debt hangover, keeping interest rates low for longer is crucial.

In fiscal terms, whilst the UK does not need a fiscal Plan B at this stage, Northern Ireland does. As with Greece, populist policy measures need to be swiftly reversed. Economically speaking, they are unaffordable, inefficient and ineffective.

The Stormont Executive's budget faces a cut of almost £1.5bn, in real terms, by 2014/15, relative to 2010/11. This has been presented as a cumulative reduction of £4bn in the block grant if expenditure had remained unchanged at 2010/11 levels in each of the four years. On their own, these are manageable; however, NI has its own devolved fiscal austerity to administer. The cost of devolved policies such as free prescriptions, free public transport for over 60s, lower tuition fees and no water charges all, effectively, have to be funded through public expenditure cuts to balance the books. Not implementing water charges alone costs, under the estimates of experts is as much as £600m per year - or cumulatively £6bn of cuts in public services elsewhere. There is an alternative.

Without any increases in revenue, the Executive has to live with around £10bn less public expenditure (**cumulatively**) over the next 4 years. It remains to be seen where these reductions will be made, but households on lower incomes, who use public services predominantly more will suffer the most. In this respect, retaining no water charges and free prescriptions for everyone, including the better off, is simply a waste of money. Northern Ireland's public finances and its economy need an about-face on these issues, and they need it quickly. As John Maynard Keynes said in response to an accusation of inconsistency: *"When the facts change, I change my mind"*.

Richard Ramsey,
26 August 2011

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