

## **Austerity v. Growth**

*This article offers an excellent analysis of the big economic debate in 2011-12 about whether the coalition government's spending cuts were too deep and/or too fast. It is also a good example of how the experts on the two opposing sides of the debate were in practice not that far apart, despite the ferocity of politician's arguments on the same subjects.*

**Evan Davis, BBC Radio 4 Today Programme, Friday 10 February 2012**

Something has been bugging me for quite a while - the degree of political and partisan polarisation on the issue of austerity versus growth. Some commentators want to stick with Plan A, the cuts and all that, while others want to abandon it, cut less far and less fast. To me, this looks like a rather hideous dilemma and quite a technical one at that: You cut debt, that is good, but gives you less growth. Borrow more, that gives you more growth for a while, but saddles you with more debt. But I notice that many protagonists in the argument feel very strongly about it indeed. It's not just politicians - respectable economists disagree vehemently.

So I brought together two economists, who are both well respected and who are some way apart on the issue, to do a neat little explainer to help you make up your mind on the issue. Jonathan Portes, director of the National Institute of Economic and Social Research, believes that what's required at the moment is a short term, temporary fiscal stimulus to boost output and jobs. Roger Bootle, managing director of Capital Economics, thinks it would be dangerous for the government to divert from its Plan A. Now it sounds like they must disagree on quite a lot, right? But actually they agree on a lot too.

Let's start with the idea that austerity actually gives you growth. The government would love to believe it - the doctrine of expansionary contraction. "I think it is largely discredited," says Jonathan Portes, citing a comprehensive review of the empirical evidence by the IMF. But Roger Bootle goes further. "I'm not sure it's been discredited, because I'm not sure it was ever credited in the first place," he says. "What happened is that there were a few, I think, very tendentious studies of particular episodes in the past, which seemed to suggest that you could contract fiscally and the economy could bounce back. "In fact those countries were operating in very particular circumstances - they were able cut interest rates, they were able to drop their exchange rates, they were comparatively small in relation to the world economy. "So I think the evidence was always extremely dodgy." Right, so they agree. We don't get more growth by cutting.

Next point - what growth would we get from extra spending? How much more national income would there be, if the government allowed itself to spend and to borrow an extra £10bn, say. "I don't think that's enough, but if we spend an extra £10bn on infrastructure, that would lead to an increase in national income of about £7bn in the first year," says Jonathan Portis. "If we borrowed an extra £10bn in order to make temporary cuts to national insurance contributions, for

example, we might be talking about an extra £5bn or so in the first year. " Pause there for a moment - £5bn of extra national income in an average total of £1.5tr. And that's for £10bn of extra borrowing - we don't get out of bed for £5bn. That all implies something very important. Chancellor George Osborne has tightened fiscal plans by about £15bn. That can hardly account for the economy flat-lining. What would have happened if he had stuck to the old government's plans?

Not that much, says Jonathan Portes. "We would be borrowing somewhat more, growth would be somewhat higher, but not hugely higher, and unemployment would be somewhat lower but not hugely lower." Roger Bootle thinks that is probably right, but it isn't the whole picture. "The interesting question for me is how much higher would government bond yields have been?" he asks. "We don't know, but I think they could well have been materially higher. The point is, that once you have lost the confidence of the markets, it is very very difficult to regain it. "Now of course, George Osborne can't be sure that he's got the confidence of the markets forever, but what he did do, by being tighter than the previous government, is he won their immediate confidence at least for a time. That may last, it may not."

You might be thinking that it's rather surprising, that if you borrow and spend you don't get a bit more bang for your borrowing buck. Well it's all to do with the fact that as you inject into the economy, a lot of the money you've injected leaks away. It's spent on imports, or it's saved. A big economy like the US, which imports less, is very different. There, less leaks away, as Jonathan Portes explains.

"You would expect the multiplier, the impact of a tax cut or extra spending on growth, to be significant greater in the US, because considerably less of it would leak away through imports. "If you put more money in people's pockets here, they'll spend some of that on things which are imported from abroad, that's much less true in the US." And again, Roger Bootle agrees: "The impact is quite interesting. It means that in the same circumstances, there is actually a stronger case for an equal fiscal expansion in the US, than there would be in the UK."

Oh dear. It's the most vicious argument in economics and my two antagonists appear to entirely agree. So where do they differ? It all comes down to the risks of a stimulus. "We don't know, actually, what the ultimate impact of all this stuff is, because we don't know what the market reaction is going to be," says Roger Bootle. "You might say 'if the amount is small, then surely the market reaction should be small', but that doesn't follow at all. "What the markets will say is 'what does this £10bn mean? Is this the end of it? Is it £10bn and then finish, or is this the start of something much bigger?' "They'll also say - 'by the way, if the British can't cope with this degree of austerity, after only a year or 15 months, what are they going to be like in years three, four, five, six and seven. "So you could end up, I think, with a position where just a small bit of relaxation, actually, could end up having a substantial negative impact."

Jonathan Portes, though, says the markets are not the only consideration. "Yes, it's not nice to have fingers pointed at you, and to have criticism from investors,"

he says. "On the other hand, it's not nice to have a million people, who don't need to be unemployed, who are unemployed because of the macro-economic position of this country, not because of structural unemployment, but because macro-economic policy has got it wrong. "That is a lot more unpleasant, both for them in the short term, but actually for the economy in the long term.

"So there's partly a balance of risks, and what really upsets me about some of this debate, is people talk about the market risk, and it's right to worry about the market risk, but they don't talk about the certainty, that we're doing long term damage to our own people, especially our young people. So they agree on two points - there is a risk of the market losing faith in the economy, but there is no doubt that austerity, and Plan A, is impacting negatively on UK growth at the moment.

In a way, if you are making up your own mind, the question is what kind of pain, what kind of risk, you are most comfortable taking.