IT’S TIME FOR SOME FRESH THINKING
by Alf Young

With a UK general election little more than a week away, our economic destiny has featured almost as large as Nick Clegg’s personality.

We now know that the Scottish economy has, like the UK as a whole, emerged from the deep, protracted recession that gripped much of the developed world after the cataclysmic global banking collapse. UK growth in the final quarter of 2009, first estimated at a meagre 0.1%, was revised up and up again to 0.4%. The only comparable Scottish figure, now released, is growth in the same quarter of just 0.2%.

While the UK economy as a whole endured six consecutive quarters of shrinking GDP, Scotland’s economy contracted for only five. But the cumulative lost output from this recession north of the border (6.1%) is marginally more than the loss in the UK economy as a whole (5.9%). Deeper but shorter. It’s difficult to extract much comparative comfort from that.

In the immediate aftermath of the slump, its impact on jobs looked less profound than first feared. However the latest figures, up until the end of February, have taken UK unemployment on the ILO measure above 2.5m, the highest jobless total since 1994, equivalent to an unemployment rate of 8%. The Scottish figure is 208,000, a jobless rate of 7.8%.

The prevailing consensus is that recovery remains fragile, that the chances of a second recessionary dip cannot be ruled out. The first indication of economic activity in 2010, just out, is disappointing. In spite of survey evidence pointing to a stronger rebound, the National Statistics preliminary estimate of UK GDP growth for the three months to March is a rise of just 0.2%, half what many City forecasters were predicting. So uncertainty persists. And the road ahead poses some big challenges.

To prosper again our economy cannot simply get back to normal, return to the consumption-led boom times that preceded the crash. A period of painful rebalancing lies ahead, all the way from repairing strained household budgets to clearing up the country-by-country fiscal consequences of the crash and tackling the unsustainable structural imbalances that have emerged in our globalised trading world.

Fixing the global banking system means putting in place credible regulatory controls and structural reforms that try to ensure the “too big to fail” mentality and the market recklessness that went with it does not re-emerge. Nowhere is that more important than here in Scotland where financial services remain a key sector but our two largest banks are currently, in large measure, state owned.

Unpredictable natural disasters, like the volcanic eruption in Iceland which closed much of Europe’s airspace for six days, demonstrate that, despite our technological sophistication, things happen that can paralyse everyday life and remind us all how small a step it can be from mastery of the universe to mass helplessness.

While these challenges are great, it’s also worth reflecting on the ways in which this recession, despite its historical significance, has been quite different in texture from previous slumps. For many people, an extended period of exceptionally low interest rates has proved benign. Many mortgages are costing less to service. If you are in secure employment and not over-burdened with credit there must be a temptation to wonder: Recession, what recession.

While some Scots have paid for this recession with their jobs, their numbers are, as yet dwarfed by what happened in past periods of economic distress. Scotland’s superior labour market performance in recent times contrasts starkly with what was the norm in the recessions of the 1970s and 1980s. Then Scottish unemployment was dramatically higher than the UK as a whole, at times almost double the UK rate. The great unknown now is what impact a sustained round of public spending cuts to come will have on employment levels in the public sector. Significant workforce reductions in response to sharply lower budgets could quickly banish the notion that today’s labour markets are much more recession proof than those of old.

For now the relative resilience of labour markets in this recession has helped limit the scale of the fiscal crisis we now face. Falling numbers on Jobseekers’ Allowance and better-than-expected tax receipts, allowed Alistair Darling in his March Budget to trim projected UK government borrowing in the fiscal year just ended by £11bn to £167bn. The actual year-end borrowing figure, now released, has actually undershot even that forecast, at just over £163bn. That is still an eye-popping figure, a post war record. And UK net debt, which has doubled in this parliament, will continue to rise, peaking at £1406bn, or 74.9% of GDP, in 2014/15. That’s nearly one and a half trillion pounds, the kind of number most of us struggle to comprehend.

Whoever wins this election, restoring some kind of order to the public finances is an inescapable challenge. But for all the skirmishing over which party has the more credible deficit reduction plan, an argument which dominated the run-up to the campaign proper, the actual sums that divide them are, in the context of one and a half trillion pounds of debt, almost vanishingly small.

Under the current Government’s plans, the deficit (the difference between what it spends and what it takes in in taxes and other receipts) will be halved in four years. On the latest Red Book projections, net borrowing falls from 11.8% of GDP in the fiscal year just ended to 5.2% in 2013/14. The Opposition wants to eliminate the “bulk of the structural deficit” in the lifetime of the next parliament.

If elected, the Conservatives also want to start tackling the deficit as quickly as possible. According to the independent Institute for Fiscal Studies (IFS), their plans suggest an extra fiscal tightening of £8bn over what Labour plans by 2015/16. But, in the context of that whopping debt mountain by the middle of the decade, an additional squeeze of £8bn a year looks like very small change indeed.

The other area of contention is where precisely the pain should be felt. The present Government prefers a balance of roughly one-third tax increases, two-thirds spending cuts by 2013/14. The Conservatives would shift that to one-fifth tax rises, four-fifths spending cuts. The serious options don't stop there. The Liberal Democrats, buoyed by their man's performance in the televised debates, are now potential kingmakers in a hung parliament. So their prescription for getting the public finances sorted can no longer be ignored.

The LibDems' big fiscal idea isn't about deficit reduction. It's a major reform of income tax, taking the threshold for paying it at all to £10,000, funded and more by higher taxes on the better-off. On deficit reduction, the IFS thinks LibDem ambitions are pretty much in line with Labour, with a slightly higher share of the pain falling on higher taxes through to 2013/14, followed by an even tougher approach to public spending thereafter.

However since all three parties are reluctant to spell out, in any detail, where the spending axe might fall beyond the fiscal year just started, it is almost impossible to have a meaningful debate about what these three approaches might mean in practice. The instinct, on all sides, is to wrap the bitter pill to come in more anodyne coatings, labelled efficiency savings or tax avoidance crackdowns.

It is much easier to promise results from them than to deliver meaningful savings. And up till the whole process has lacked the transparency that comes with reporting tax receipts or government borrowing. Even the National Audit Office questions some of the suggested proceeds from efficiency drives. The political equivalent of the tooth fairy, commentator Simon Jenkins calls them.

So whether the latest promised efficiencies materialise and more people and businesses are made to pay the tax they owe there are still going to be massively challenging spending cuts over the lifetime of the next UK parliament whoever is in power. And if some major services, like the NHS, are protected from the squeeze, the pain felt elsewhere is bound to be even more acute.

Significant cuts in public spending will help shape our economic prospects for years to come. But in this election campaign we are flying blind on the issue. As the IFS puts it: "Each of the three main parties has only filled in a small part of the deficit reduction plan jigsaw - in each case we would have to wait for a post-election Budget and/or Spending Review for a more complete picture to be filled in."

The picture is even more complicated here, where the Scottish Government disputes the need for spending cuts at all and is calling for the post-recession stimulus to continue. But deep down it must know that, whoever gains power at Westminster, cuts are coming and Scotland will be called upon to take its share. With little fanfare, in anticipation of that reality, the Scottish Government has even created its own Independent Review Body (IRB), chaired by Crawford Beveridge, to assess the consequences of all this fiscal tightening to come for its devolved budget

Using IFS projections, the IRB is already projecting a cumulative reduction of £3.5bn in real terms in the three years from 2011. From the peak DEL budget of £29.5bn available to the Scottish Government in the fiscal year just ended, that represents an overall cut of 11.9% by 2013/14.

Capital budgets are expected to bear the brunt, falling by an average 12% for each of the next four years. That means investment in infrastructure will almost halve by 2014. So this is completely new territory for devolved Scotland. The years of sustained plenty in public spending are over. Some very tough choices lie ahead for whoever is running Holyrood from May 2011. “A new approach is needed that fundamentally reviews priorities and the delivery of services,” argues Audit Scotland.

After a decade of significant real-terms growth in public spending, this decade will be very different. Many of the initiatives debated at the Council’s recent Forum in St Andrews, captured in its theme of re-wiring Scotland, will only bear fruit if we become much, much smarter at leveraging the public resources available to us to much greater effect than before. It’s a daunting challenge - but an exciting opportunity for fresh thinking, too.

Alf Young is Special Economic Counsel to the SCDI board

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