SCOTLAND MUST FIND A PATH TO GAIN AMID THE PAIN

by Alf Young

It seems a very long time since the Conservative Party, in opposition, was talking about sharing the proceeds of growth. In his first emergency Budget, George Osborne, the new Chancellor of the Exchequer, could talk only of sharing the deep pain of the most draconian changes to the public finances for many decades.

The fiscal tightening now proposed over the next five years is eye-wateringly severe. Alistair Darling had already bequeathed to his successor a massive squeeze totalling £73bn, designed to cut the UKqs deficit in half over four years. To that George Osborne has added a further £40bn tightening designed to eliminate the UKqs structural deficit altogether and set the stock of national debt on a downwards trajectory by the end of this parliament.

Thereqs a net £8.2bn increase in taxes, dominated by a rise in VAT to 20% next January. The LibDemsq pre-election %bombshell+ exploded weeks later with two of them flanking Mr Osborne on the government front bench. Add to that nearly £32bn of spending reductions, including £11bn in cuts to a wide range of welfare benefits. Outwith the NHS and the international aid budget, other departments of government face an average 25% cut in budgets over the next four years. The full consequences, including those for the UKqs devolved governments, will be spelt out in a new Comprehensive Spending Review on October 20. The pain will intensify right through to 2014/15.

The Chancellor claims this budget was %unavoidable+. Without it, the UK would have been at the mercy of the financial markets and the rating agencies, its sovereign debt levels regarded as unsustainable as those of Greece, Spain or other Eurozone targets of recent weeks. But budgets are always judgement calls, balancing competing risks. And the other risk with this one is that it gold plates Britainqs AAA credit rating but snuffs out a fragile recovery before it manages to take proper hold. It is, in short, a huge political gamble.

If, and itqs a very big if, this budget succeeds in rebalancing a shrinking state and more constrained personal consumption with an export-led, jobs-rich private sector recovery by the middle of this decade, George Osborne will be vindicated. If it doesnqt, the consequences - in terms of lost jobs and reduced living standards - could mean this Chancellor never gets to deliver his longer term goal of %prosperity for all+.

In its first budget forecast, the new independent Office for Budget Responsibility certainly concedes the Osborne measures will put growth over the next couple of years under greater pressure. In its first pre-budget forecasts published on June 14, the OBRqs central projection was GDP growth of 1.3% in 2010 and 2.6% in 2011. It is now projecting falls in these figures to 1.2% and 2.3% respectively. From next year onwards right through to the end of this parliament, it is also suggesting there will be 100,000 fewer people in employment than it projected before the budget was revealed.

With the full consequences of real-terms spending cuts of 25% in most government departments yet to be revealed in October, it is hard to believe the jobs cull in such labour-intensive services will stop at just 100,000. Cuts on that scale cannot credibly be delivered without affecting delivery of frontline services. To be fair to the OBR, it is at pains to stress that all forecasting, especially fiscal forecasting, is an uncertain business.

Its growth forecasts are no longer the kind of target ranges used by the previous Labour administration, but the kind of probability fan charts used by the Bank of England in its pursuit of monetary policy. The OBRqs role is to decide whether %the governmentqs policy is consistent with a better than fifty percent chance of achieving the fiscal mandate (set by the Chancellor).+It is in the business of managing the unknown, not delivering certainty.

And, as we have discovered with the Bankqs pursuit of its inflation target in recent years, delivery can drift quite a long way from intent. Indeed, in his recent Mansion House speech, the Bankqs Governor, Mervyn King, was moved to defend his Monetary Policy Committeeqs record which has been above its 2% inflation target for much of the past three years. It was all the fault of falls in Sterlingqs effective exchange rate, he explained. And, in the MPCqs defence he added, a weaker pound was helping to rebalance the UK economy.

Historical comparisons are another way of demonstrating what a high-risk undertaking the Chancellor is embarked on. The last time the Conservative Party used VAT as a surprise weapon in fiscal consolidation, doubling it to 15% early in the first Thatcher administration, that assault on government net borrowing managed to bring it down from 5% of GDP in 1978/9 (the final year of the Callaghan government) to 1% in 1987/8, nine years later. This time George Osborne is looking to cut net borrowing from 11% of GDP in 2009/10, the last year of the Brown government, to just 1.1% in 2015/16, six years later.

Twice the pace of fiscal consolidation delivered in two thirds of the time Mrs Thatcher took. Thatqs an extraordinarily ambitious undertaking with no guarantee of success. And it is being delivered against a very different global economic backdrop from what prevailed in the 1980s or indeed in the 1990s, when the new governmentqs favoured comparators, Sweden and Canada, were embarked on their austerity drives.

This time, after the global banking crisis and the deep recession which followed, great tracts of the Western economic world remains very fragile. Time magazine has just surveyed the public finances across individual US states. We are used here to hearing of the dire state of the public finances of California. But California is far from the worst case. Its expected budget shortfall next year as a percentage of this yearqs budget is 9.1%.

In next door Oregon it is 19.3%. In Arizona 35.3% and in the worst case of all, Nevada, 56.6%. Some east coast states are faring no better. New Jerseyqs projected shortfall is 37.4%, Maineqs 32.1%. Little wonder that President Obama has written to the leaders of the rest of the G20 meeting in Ottawa this weekend, pleading that they do not wind down their post crash stimulus packages too soon, a case supported by among others, the Nobel Prize-winning economist Paul Krugman.

Across Europe, as well as the savage cuts in Ireland, the Greek debt crisis and the knock-on scares in Spain, Portugal and Italy, austerity is now very much the name of the game in Berlin and Paris, where there are fears of a fresh round of failures in banks heavily exposed to Southern European sovereign debt. If more and more Western governments insist on hawkish fiscal responses, involving bigger tax rises and deeper spending cuts, it is hard to see where the export demand that will generate higher rates of private sector growth here are going to come from.

It could come, in part, from economies with strong budget surpluses like China and the oil-rich states of the Middle East doing more to boost their own domestic demand, allowing the deficit-hit nations of the West to meet that demand by selling more of their goods and services to them. But apart from the recent welcome news that China is de-coupling its currency from the American dollar, real action on this particular aspect of global rebalancing is painfully slow.

There are some measures in the Osborne package that should help businesses here to grow. The National Insurance changes and corporation tax cuts are obvious examples. But they are being paid for, in part, by quite significant cuts in capital allowances and the withdrawal of help for specific sectors, like the digital games industry in Dundee.

There is also an attempt to introduce a measure of regional policy, by offering new start companies outwith the South of England relief on employers’ National Insurance Contributions for the first ten people they recruit. But the measure is only for start-ups, is strictly time-limited and capped at £5,000 per firm. Given the state we are in it is not a panacea.

There is no shortage of good ideas around about how to put the pain of the financial crisis and the deep recession that followed behind us and rebuild a more prosperous and inclusive future for all our people. Only last week the Scottish Council for Development and Industry launched its Blueprint for Scotland. The feedback from across civic Scotland has been very positive.

However, to deliver a sustainable and aspirational environment that encourages and supports enterprise and growth, to deliver innovative and world-class delivery of public services, to deliver international success and create an inclusive and connected nation and regions, as the Blueprint advocates, will be even more challenging now that the full scale of the UK government’s drive to fiscal consolidation has been revealed. We must all now become even more innovative in how we go about delivering a stronger more sustainable future.

Alf Young is Special Economic Counsel to the Board of SCDI

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