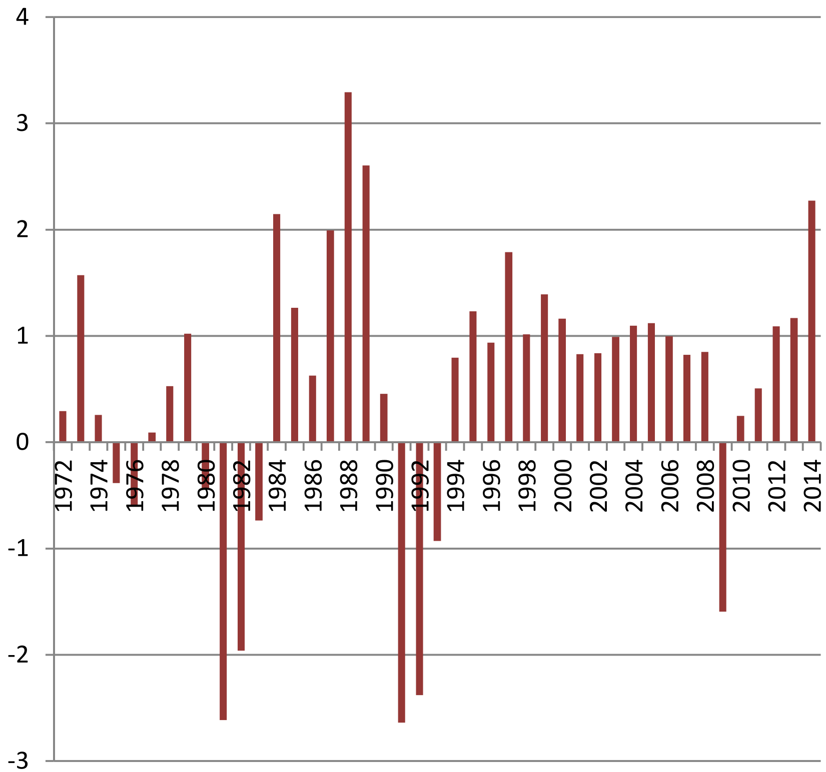
A macroeconomic/empirical case against Osborne's austerity

Budget, March 2015

"Fastest growth among G7 economies in 2014"

"increase in employment level ... largest since 1988"



Argument / outline

1. Austerity reduced economic growth
2. Labour income growth reduced in parallel, but adjustment through wages has led to red herring of productivity puzzle
3. Reduced labour income means reduced taxes etc and huge shortfall in planned deficit reduction
4. Threat of deflation a consequence of vast scale of spare capacity; policymakers deny this through extreme (monetarist) approach of writing-off capacity as not used
5. In meantime, pre-crash economy aided and abetted by CB balance sheet expansion; ongoing debt and asset inflations. McKinsey etc
6. Vicious cycle and alternative

... when sustained, fiscal consolidation increases rather than reduces the public debt ratio and is in general associated with adverse macroeconomic conditions.

'Economic Consequences of Mr Osborne'

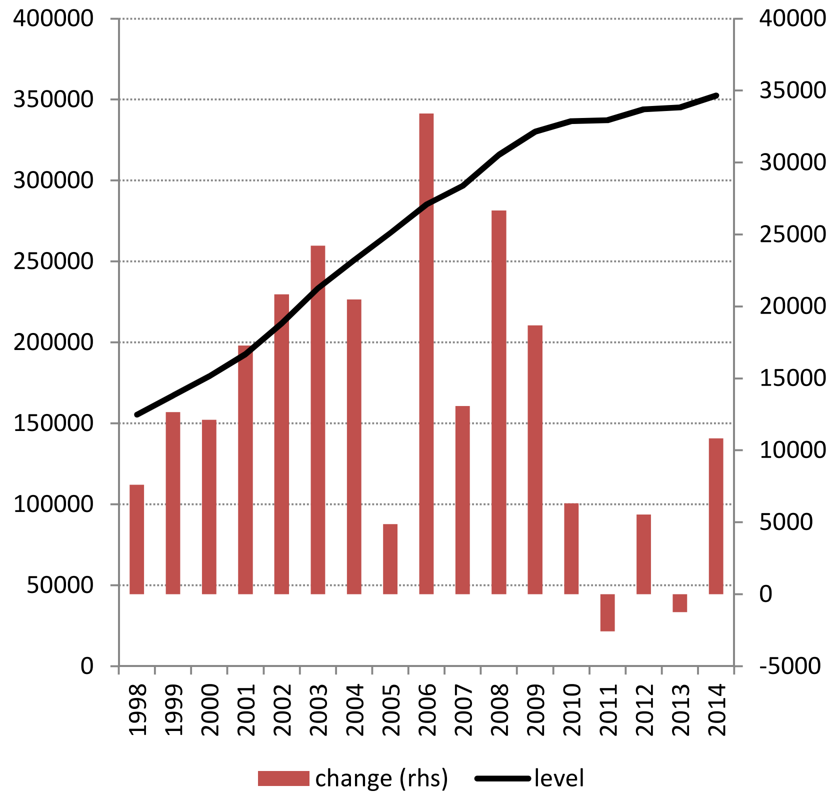
http://www.primeeconomics.org/prime-publications/

Chick, Pettifor and Tily, 2010

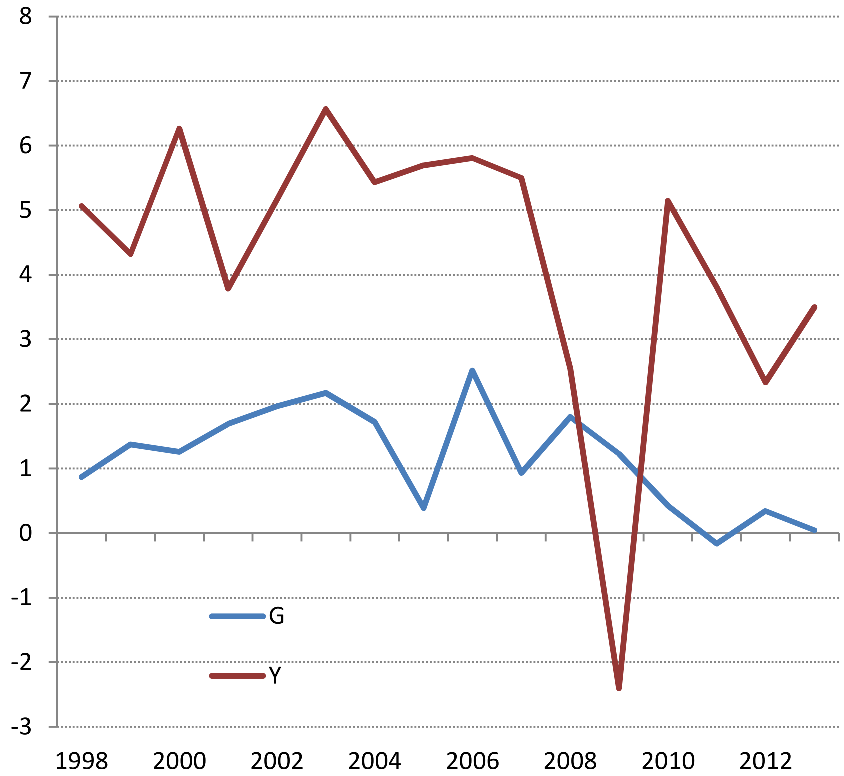
1. AUSTERITY REDUCED ECONOMIC GROWTH

For aggregate demand, overall it's about reduced growth in government spending not cuts in the level

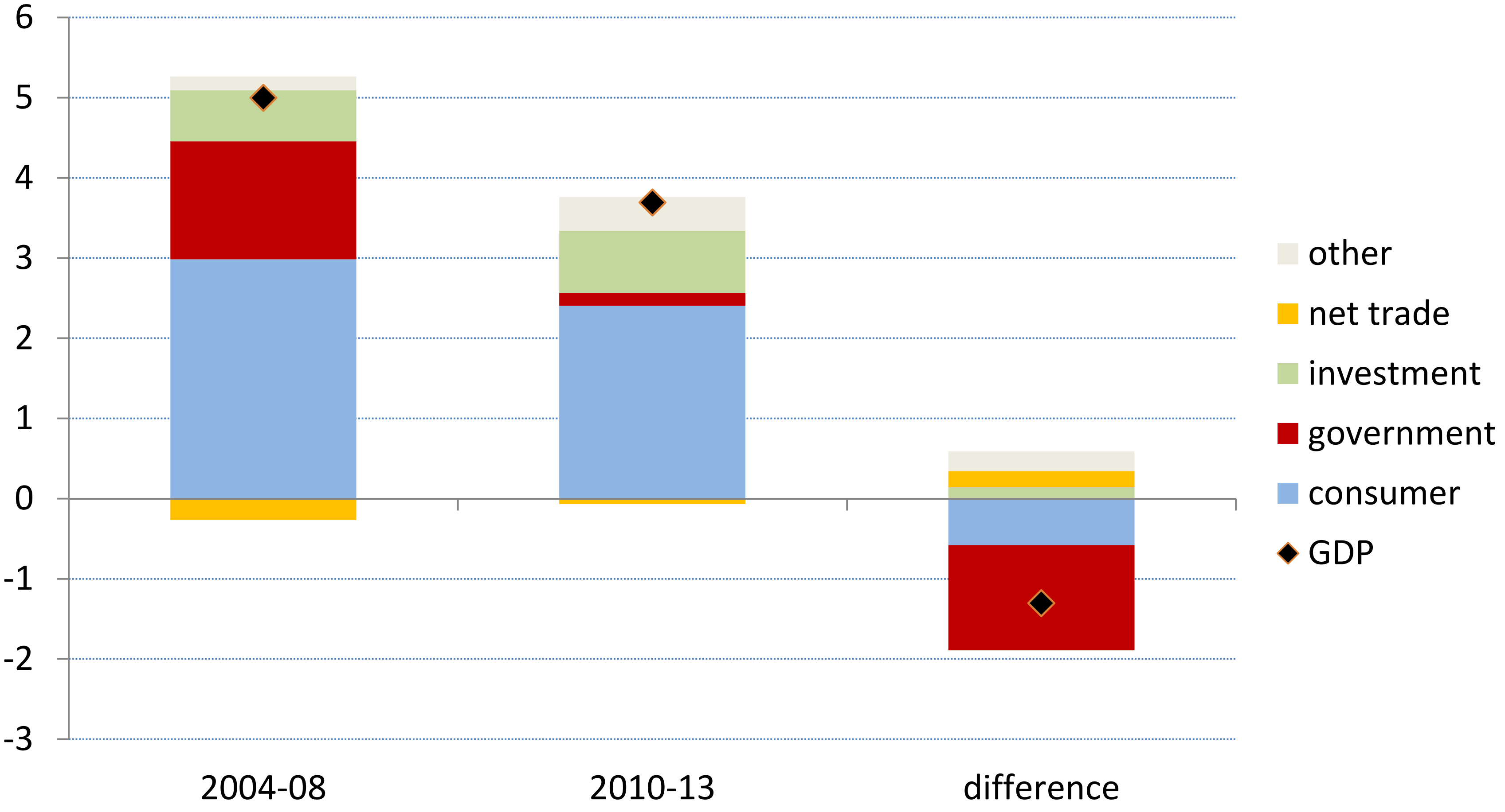
government final demand, £million

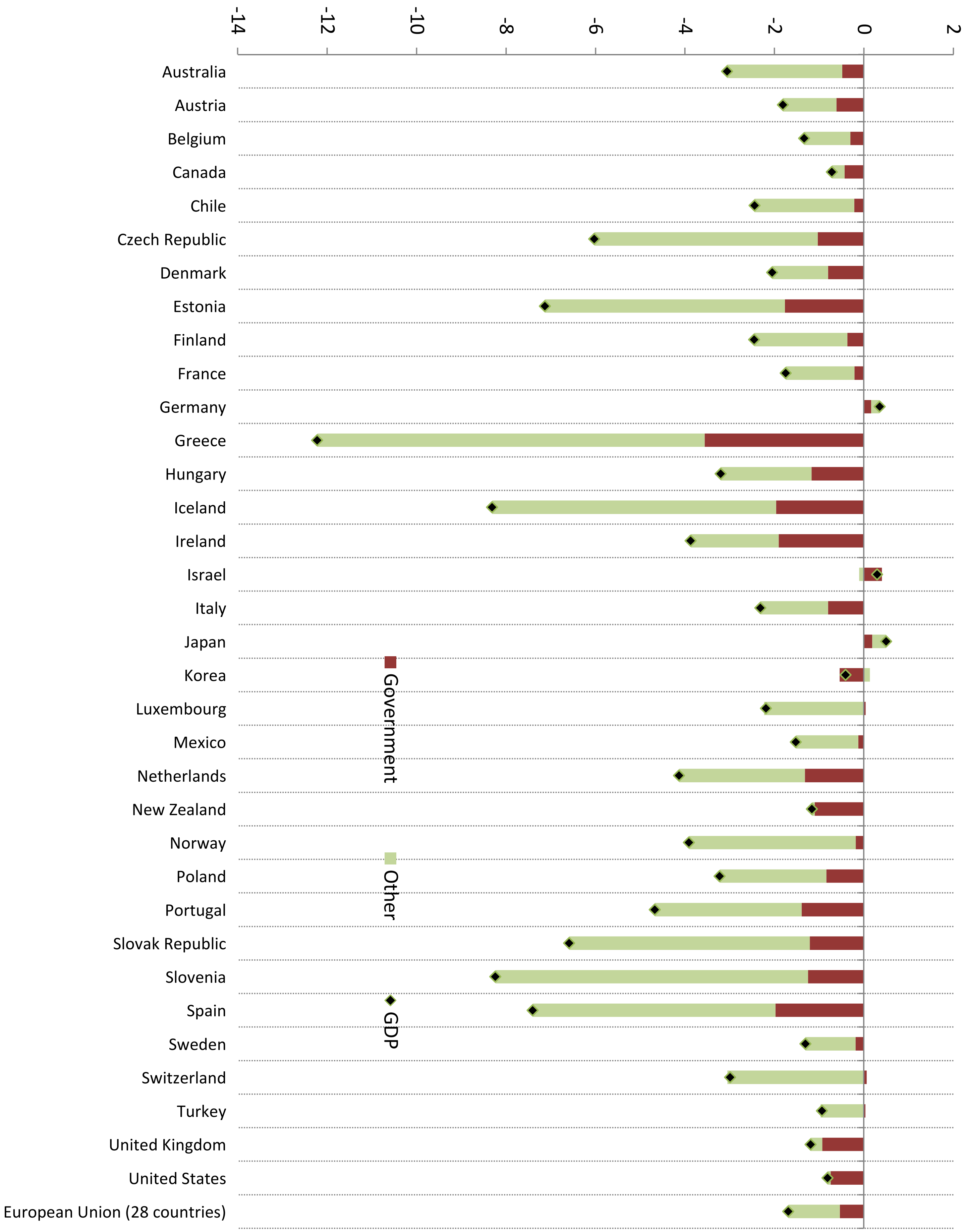


GDP and government demand growth



Contributions to GDP(E) growth, percentage points

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Australia
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Hungary
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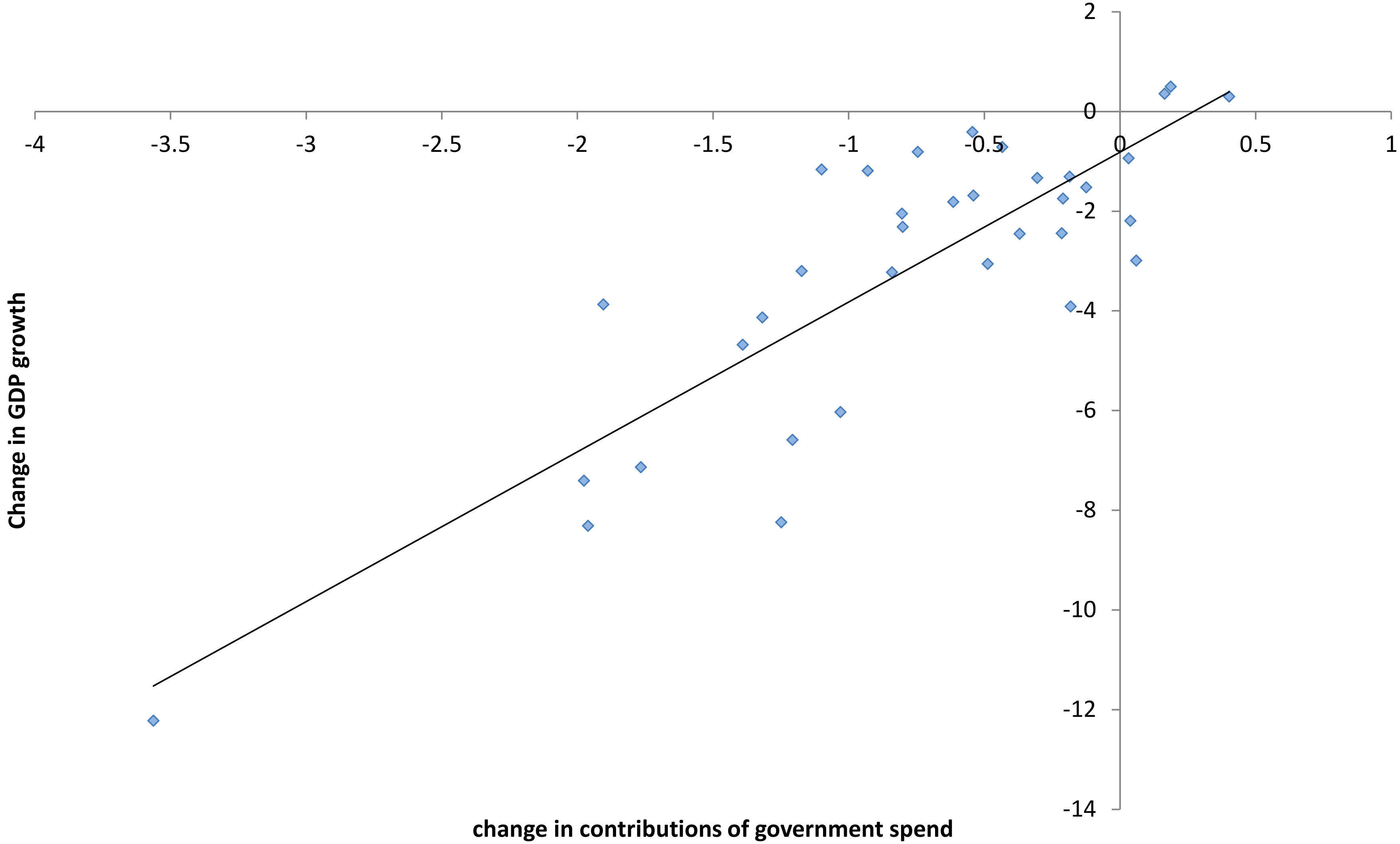
Israel
Italy
Japan
Korea
Luxembourg
Mexico
Netherlands
New Zealand
Norway
Poland
Portugal
Slovak Republic
Slovenia
Spain
Sweden
Switzerland
Turkey
United Kingdom
United States
European Union (28 countries)
Government
Other
GDP

Regression of change in GDP growth against change in government spend, percentage points



Theoretical points

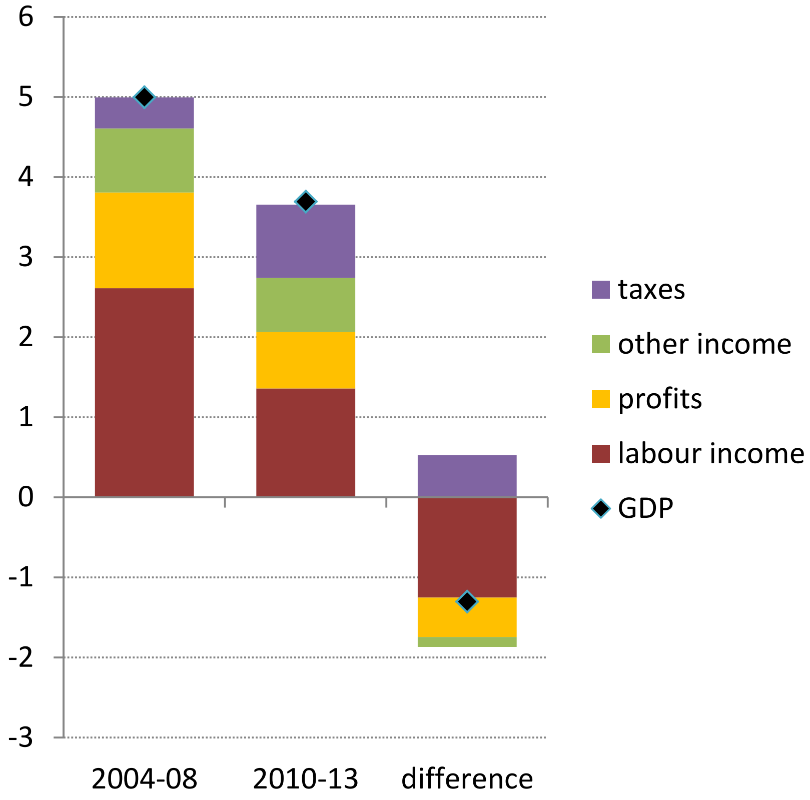
- Analysis in nominal not real terms
- Extreme policy stance: fiscal restraint vs monetary ease
- Multiplier not so straightforwardly estimated
- Either way, grossly underestimated. OBR: 0.7; CEA: 1.5

  I have typically quoted OBR figures which assume a multiplier below one, which gives me the £4000 per average household cost of UK austerity. My own best guess would be that the multiplier has been larger than one, which gives me significantly higher costs, but I have never suggested that I know with certainty what the size of the multiplier has actually been. (SWL, 19 May2015)
- Trade v OBR
- Household consumption, follows Y
- Investment, mec *v* r
- Backdrop of private debt

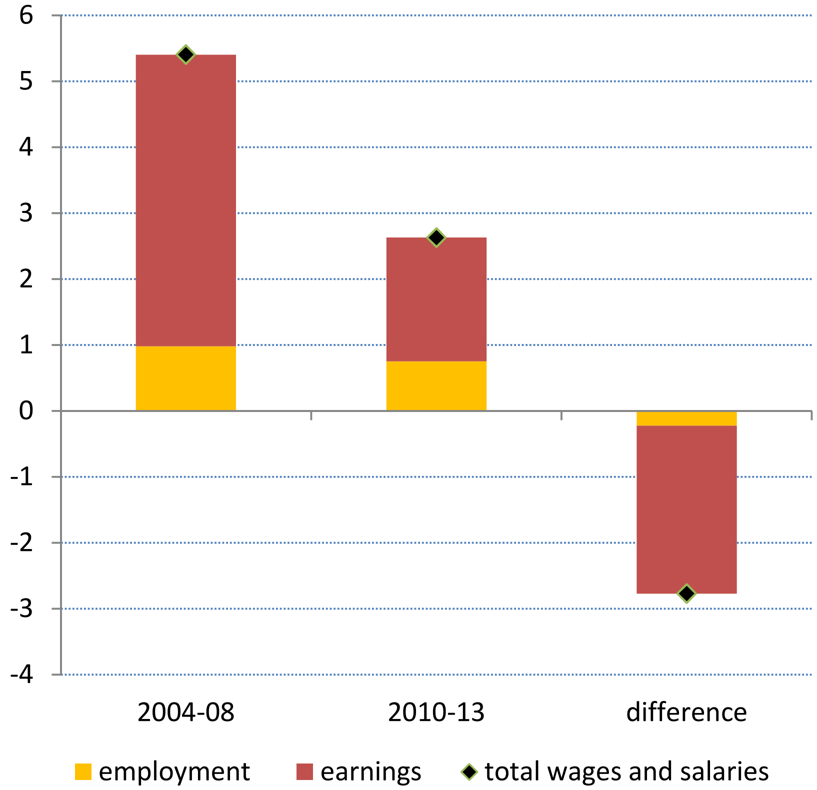
2. LABOUR INCOME GROWTH REDUCED IN PARALLEL, BUT ADJUSTMENT THROUGH WAGES HAS MEANT RED HERRING OF PRODUCTIVITY PUZZLE

GDP(I) perspective

Contributions to GDP(I) growth, percentage points



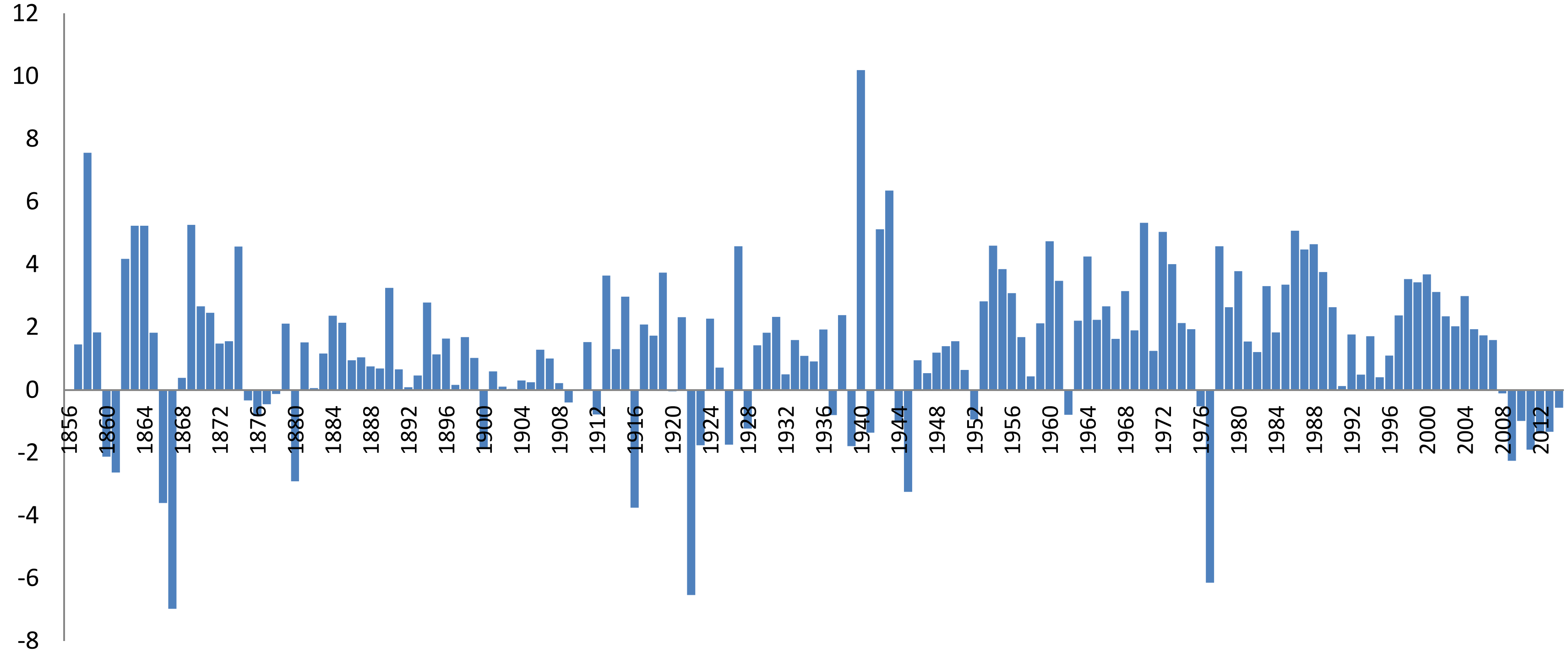
Decomposition of wages and salaries growth



Scale of fall in (real) wages is without precedent

LM is nothing to celebrate. A low-cost and fractured labour market has been forced to evolve; a structural change; entirely unnecessary.

Annual real earnings growth



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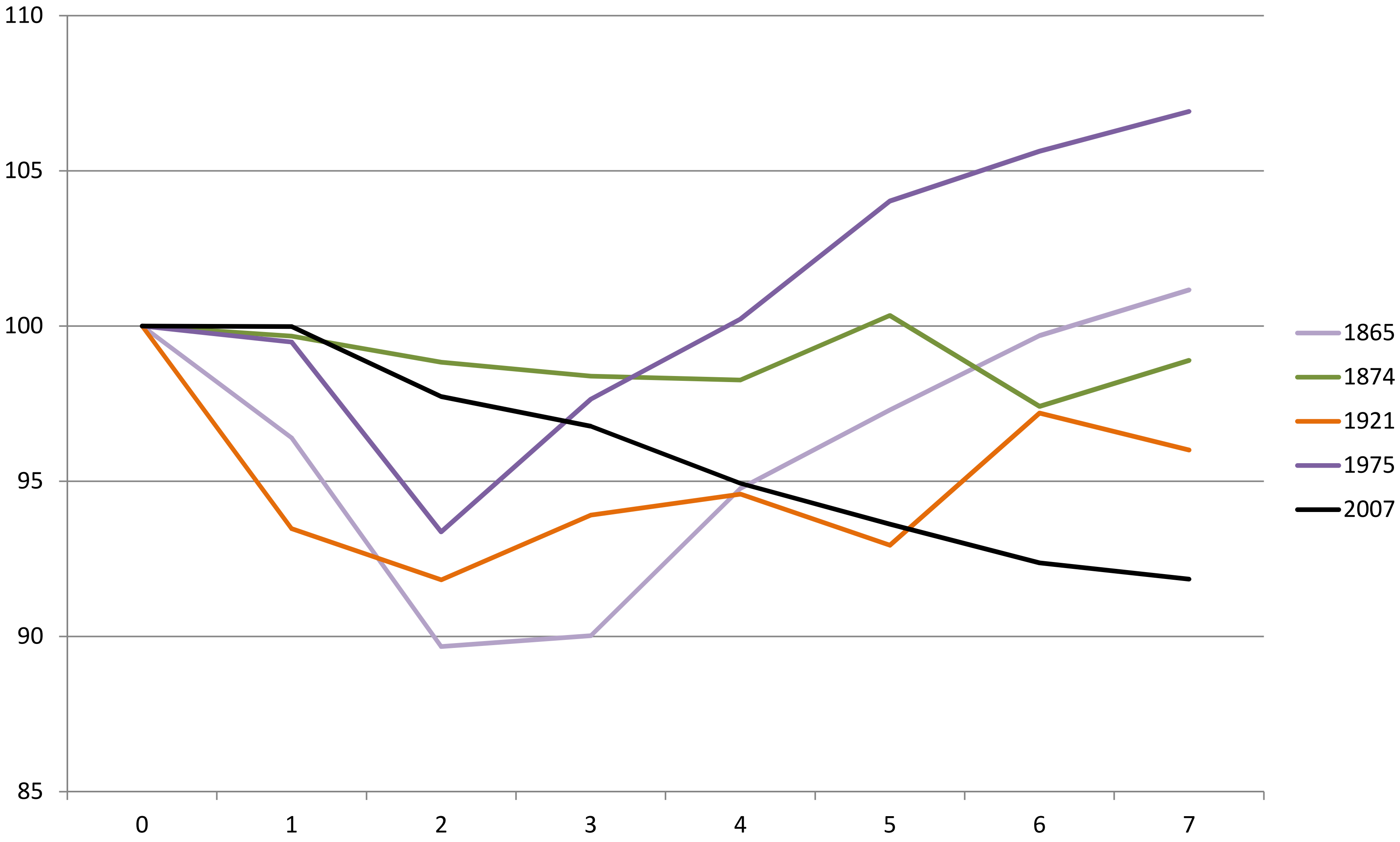
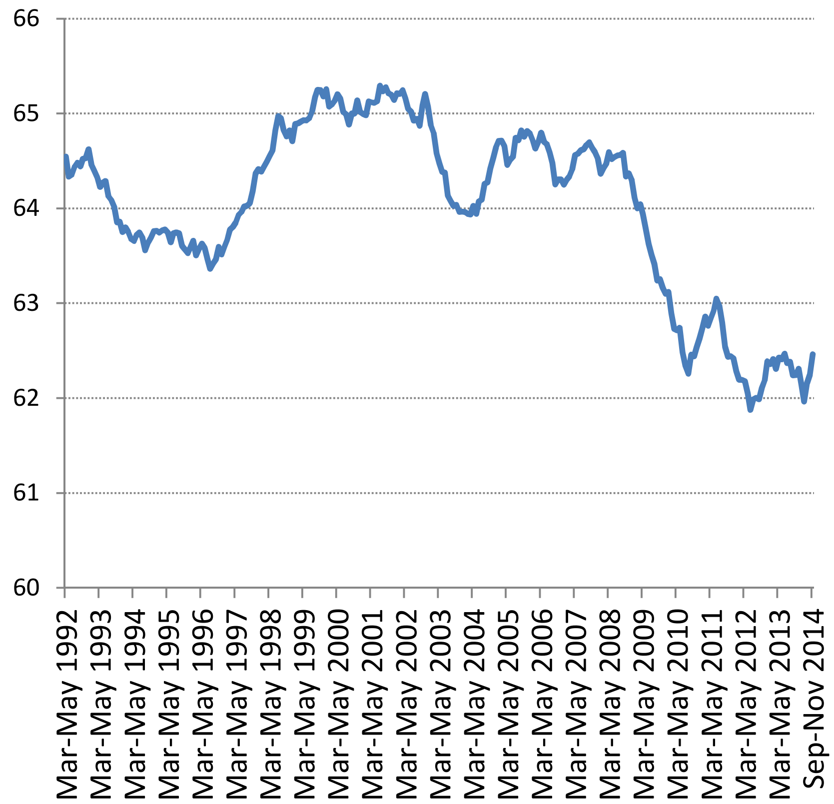
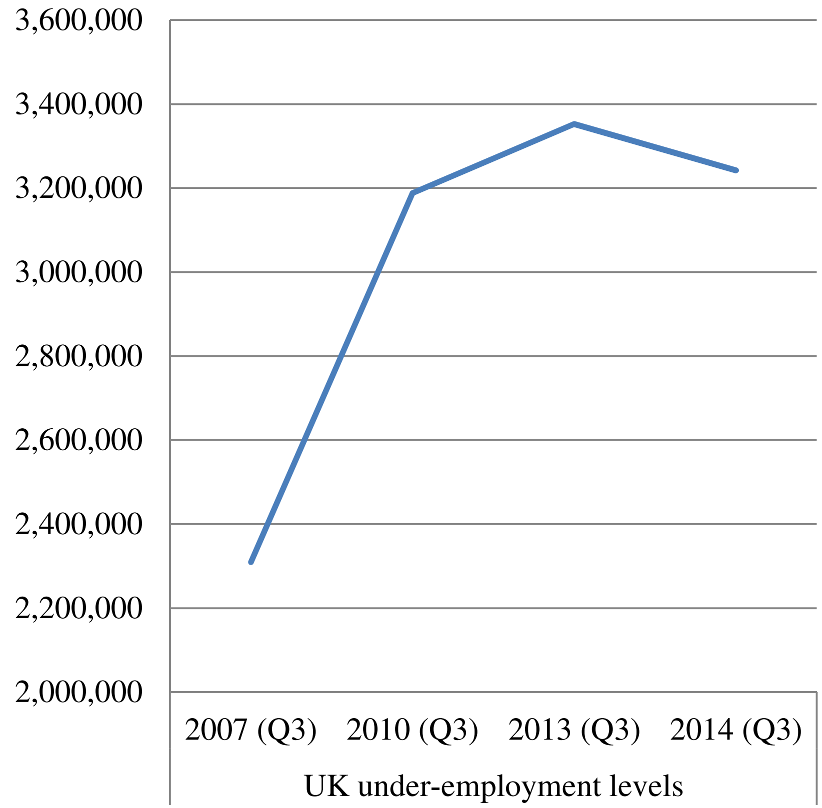


Underemployment

FT-employees share



Underemployment



Productivity (puzzle?)

For those of working age the greatest disappointment [!] has been weak improvements to living standards. Poor productivity growth has been to blame, because this has depressed the pace of the recovery and wages. (Chris Giles, FT, 19 March)

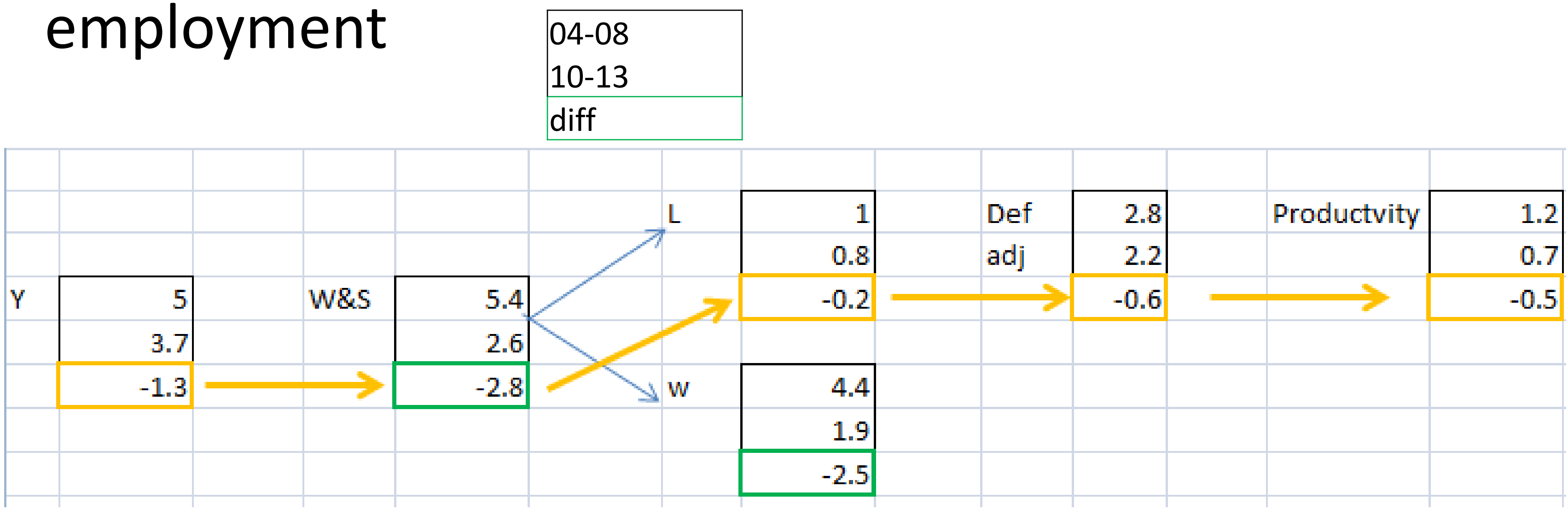
Productivity is almost everything, Peston, blog, 16 March

Demand and the ‘productivity puzzle’

- Limitless supply explanations, rigidities and misallocations.
- Micro in character, even demand.
- Demand account must be macro in character.
- *Puzzle arises from labour market adjusting to austerity-driven weaker GDP growth through wages rather than employment*

‘Puzzle’ resolved

- Simply the way the labour market has adjusted to meet lower GDP growth through low wages rather than employment



- Reality is other way round: low wages are causing low measured productivity
- But here productivity meaningless residual
- Not denying structural issues (debt overhang, financial system, industrial policy, corporate governance ...)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Spain
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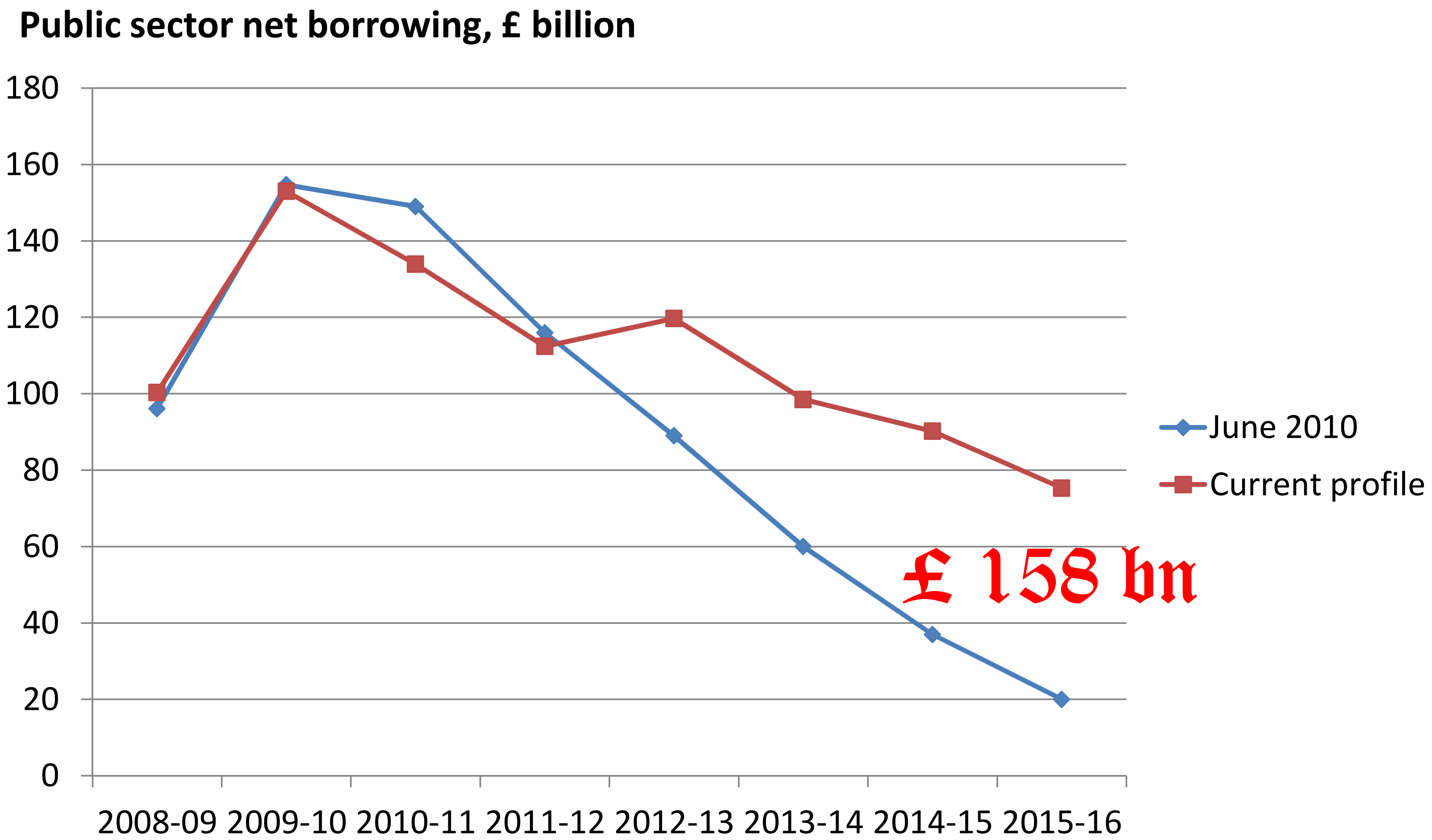
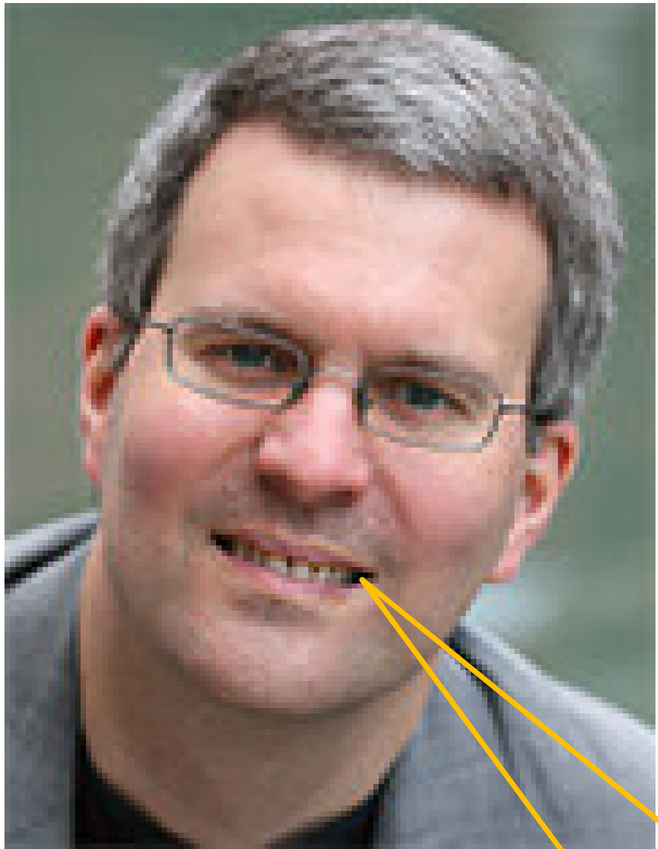
Czech Republic
Portugal
Netherlands
Norway
Ireland
Poland
Hungary
Australia
Switzerland
Finland
Italy
Luxembourg
Denmark
Austria
France
Mexico
Belgium
Sweden
United Kingdom
United States
Canada
Korea
Israel
Germany
Japan
employment
earnings
GDP

3. REDUCED LABOUR INCOME MEANS REDUCED TAXES ETC AND VAST SHORTFALL IN PLANNED DEFICIT REDUCTION

Weak incomes have meant failing public sector finances



Weak total incomes mean failing public sector finances



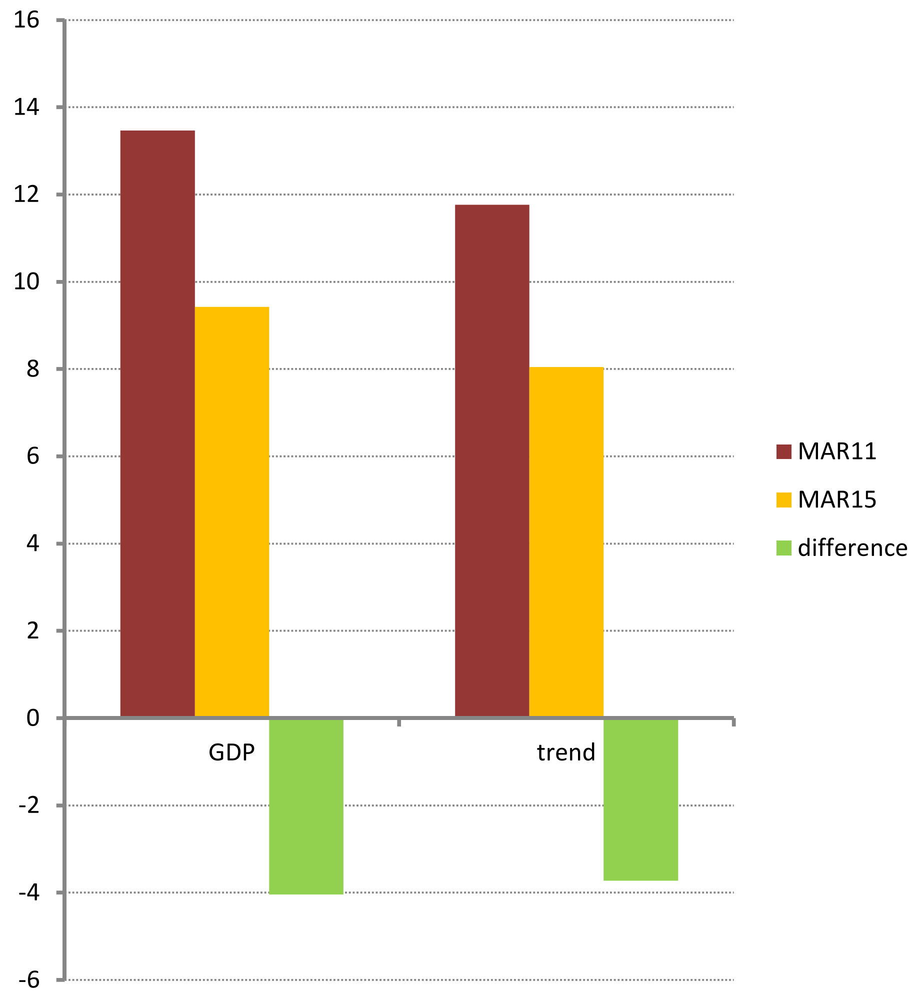
- Reduced labour income means reduced tax and NICs; tax heavily geared to earnings not jobs
- Increased cost of tax credits, housing benefit etc
- Giveaways obviously also cost government, eg thresholds and corporation tax

Illustrative calculation of shortfall

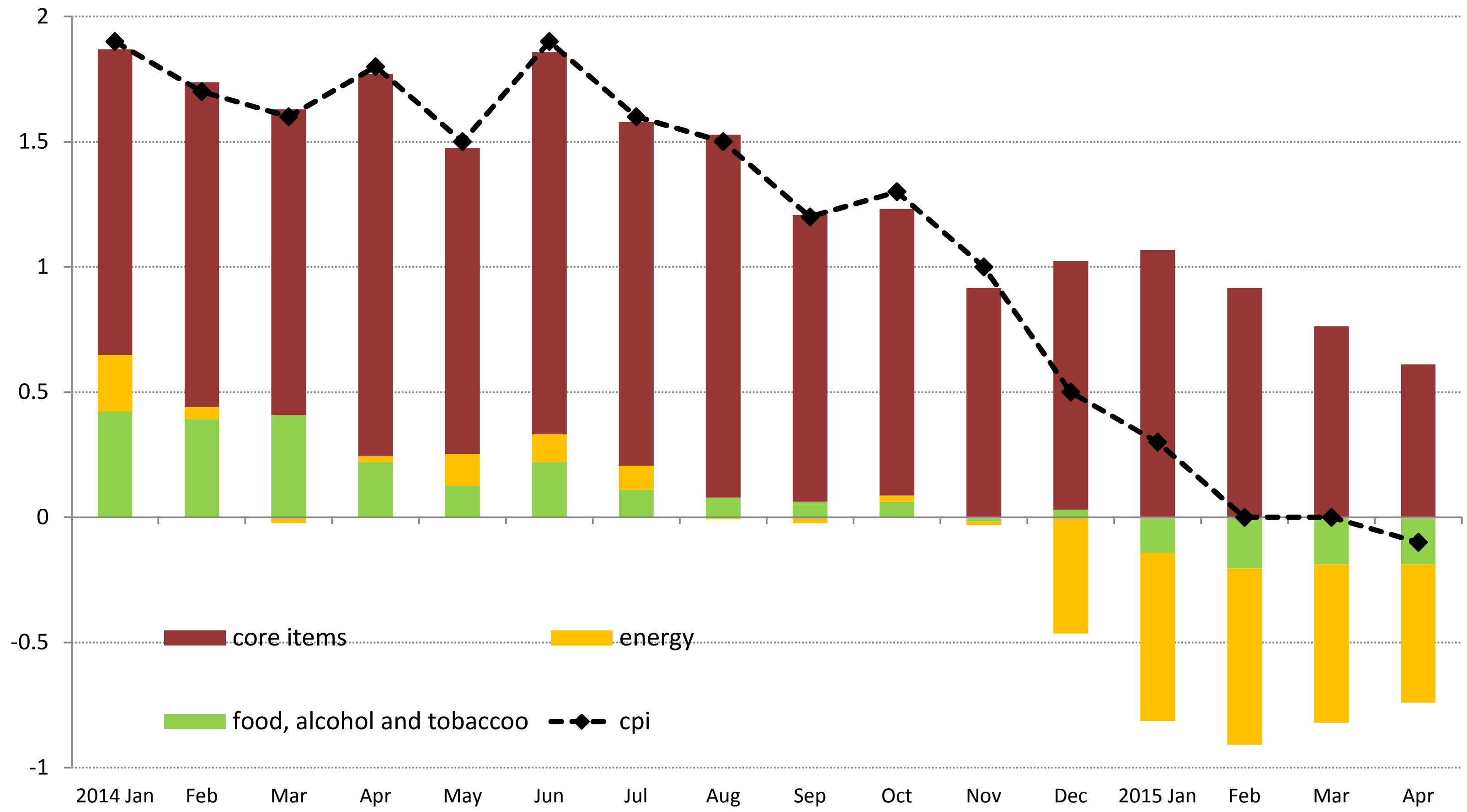
Reduced increase in government demand				-£17bn p.a		
Multiplier				1.3		
Reduced increase in GDP				-£22bn p.a.		
	Year	1	2	3	4	5
		22	22	22	22	22
			22	22	22	22
				22	22	22
					22	22
						22
Annual GDP reduction		22	44	66	88	110
Cumulative reduction in GDP, £bn		22	66	132	220	330
* 40% revenue share						132

4. THREAT OF DEFLATION A CONSEQUENCE OF VAST SCALE OF SPARE CAPACITY; POLICYMAKERS DENY THIS THROUGH EXTREME APPROACH OF WRITING-OFF CAPACITY AS IT IS NOT USED

OBR/BoE write off capacity as it is not used



Not just oil: UK CPI and contributions



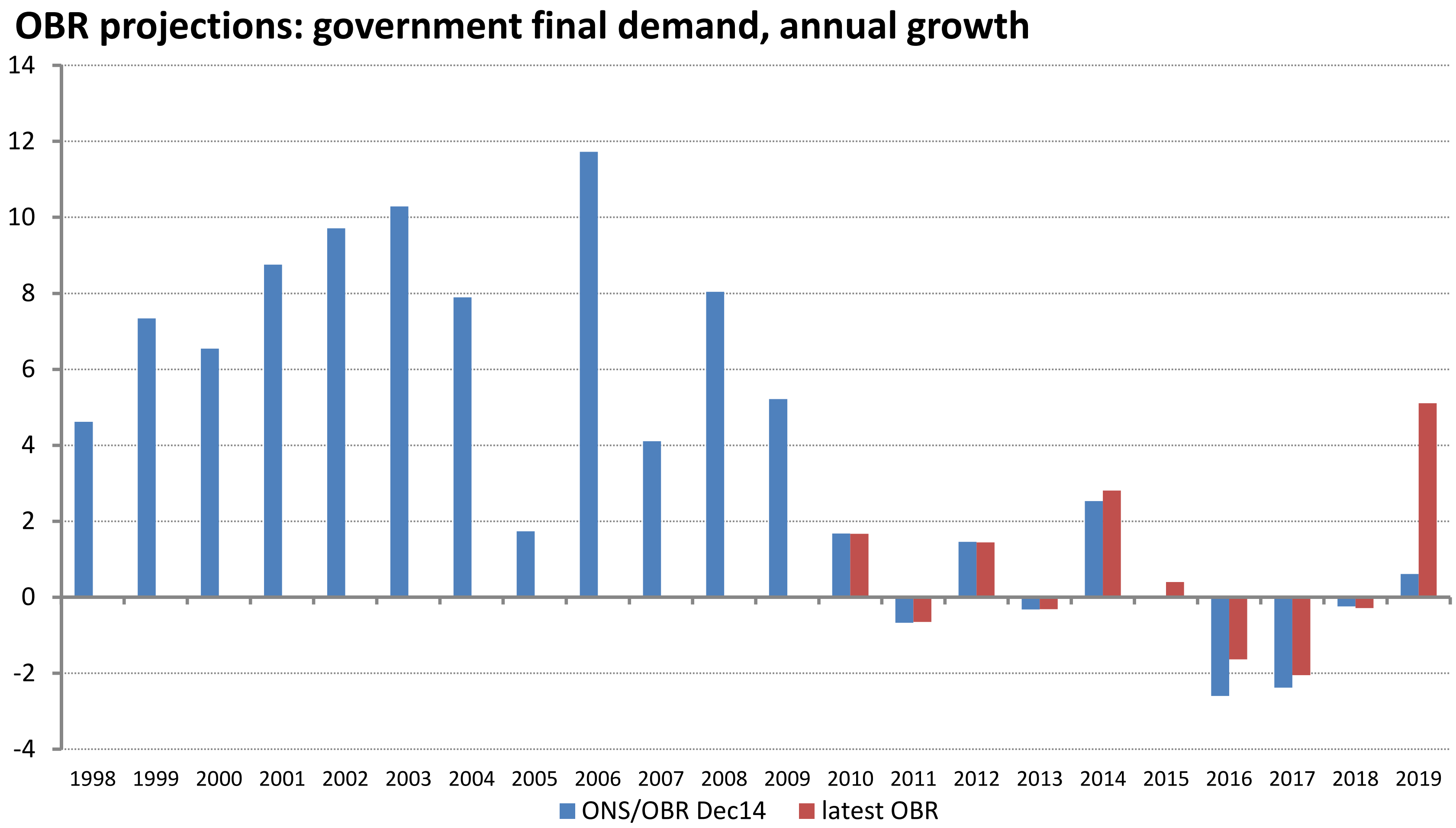
4. IN MEANTIME, PRE-CRASH ECONOMY AIDED AND ABETTED BY CB BALANCE SHEET EXPANSION; ONGOING DEBT AND ASSET INFLATION. MCKINSEY ETC

“Contrary to widely held beliefs, the world economy has not yet begun to delever and the global debt-to-GDP ratio is still growing, breaking new highs” (Buttiglione et al, 2014)

“Seven years after the bursting of a global credit bubble resulted in the worst financial crisis since the Great Depression, debt continues to grow. In fact, rather than reducing indebtedness, or deleveraging, all major economies today have higher levels of borrowing relative to GDP than they did in 2007. Global debt in these years has grown by $57 trillion, raising the ratio of debt to GDP by 17 percentage points (Exhibit 1). That poses new risks to financial stability and may undermine global economic growth. (McKinsey, 2015)

5. VICIOUS CYCLE AND ALTERNATIVE

Five years of austerity is now nine. £100bn now £200bn, if not more severe. Why should we expect anything different this time?

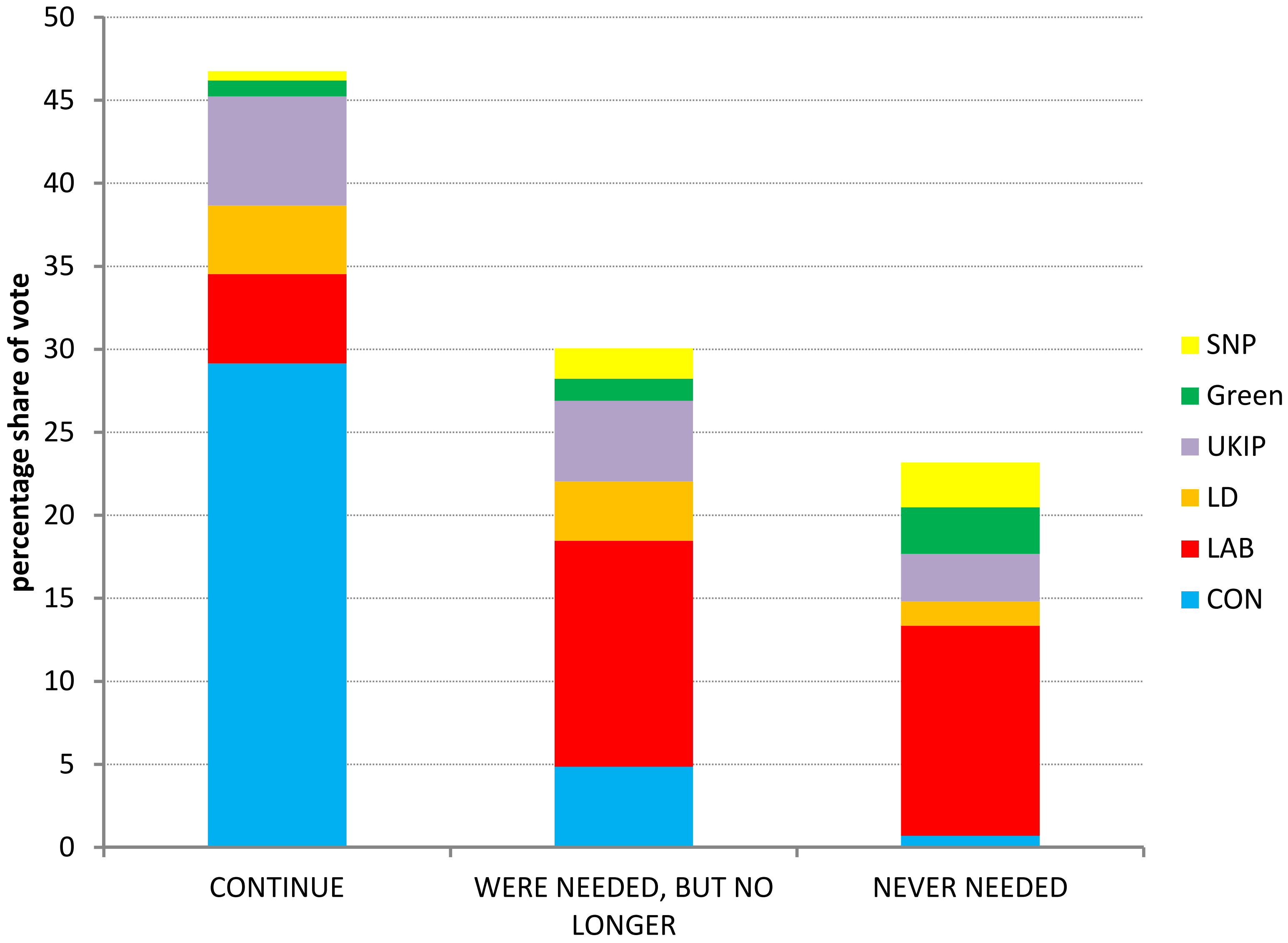


There is an alternative

- Policies must expand not retract demand
- Infrastructure spend
- Wage increases beginning with public sector
- Supply-side initiatives in tandem, not least financial sector
- You tell me.

Blog: http://ToUChstoneblog.org.uk/

Twitter: @geofftily


percentage share of vote
50
45
40
35
30
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15
10
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0
CONTINUE
WERE NEEDED, BUT NO LONGER
NEVER NEEDED
SNP
Green
UKIP
LD
LAB
CON