

£60 billion of cuts

The UK's coalition government is pressing ahead with a programme of cuts in public spending, starting immediately. Their stated aim is to eventually close what they believe to be the "structural deficit" in public spending.

The latest Institute for Fiscal Studies estimate of the gap between income and spending that the government will need to close if they are to meet their plans is about £75 billion a year by the end of the parliamentⁱⁱ. The coalition says 80% of this will come from cuts and 20% from tax rises.

This means there will be £60 billion of spending cuts per annum by the end of the parliament.

1.5 Million job losses – 4 million unemployed

When this scale of cuts is being discussed the issue is not one that can be considered at the micro level: this is a scale of cuts where the consequences have to be considered for the country as a whole.

According to HM Treasury and the Office for Budget Responsibility around 65% of UK GDP is consumer spendingⁱⁱⁱ. According to national accounts about 60% of gross value added goes to wages^{iv}. It therefore follows that a sum of between £36 billion and £39 billion (all numbers are, necessarily approximate) will be cut from total labour incomes as a result of these cuts at the national level.

UK median pay is a little short of £500 a week at present^v. That is about £25,000 a year.

If labour rewards as a result of government spending cuts are reduced by £37.5 billion (a mid point in the estimate noted above) then almost exactly 1,500,000 people can be expected to lose their jobs as a result.

A recent forecast by the Chartered Institute of Personnel and Development is that 725,000 public sector employees will lose their jobs as a result of these cuts^{vi}.

The forecast made here suggests that, within normal ranges of forecasting, for every job the CIPD thinks will be lost in the public sector another will be lost in the private sector.

There are 2.47 million unemployed in the UK now^{vii}. When these additional jobs are lost it is likely that UK unemployment will reach 4 million.

Tax Research LLP
The Old Orchard
Bexwell Road
Downham Market
Norfolk PE38 9LJ
United Kingdom

Phone 01366 383 500
Mobile 0777 552 1797
Email richard.murphy@taxresearch.org.uk
Web www.taxresearch.org.uk/blog
Skype richardmurphy1572
Registered number OC316294

How likely is this?

This is highly likely to happen but it does assume that no alternative employment is created for those state sector employees losing their jobs within the private sector. This is considered likely because:

- The Office for Budget Responsibility has forecast that current high levels of household savings will continue for the next five years, suggesting that there is limited scope for increased consumer demand in that period. This also means business will have no incentive to invest to meet increased demand.
- The Eurozone is in crisis and is facing substantial austerity cuts. They are the biggest UK export market and there is no indication of any growth prospects in that market, providing no export growth opportunities, removing all incentives for business to invest to service that need.
- The UK government, as the biggest single customer for UK businesses (as is inevitable as it represents over 40% of the economy) is cutting back its investment spending, again removing opportunity for business growth and removing all incentive for business investment to service government needs.

For these reasons it is considered highly unlikely that the private sector will recruit those being made redundant by the government over the next few years. Those people will become unemployed.

The private sector will, however, also bear its share of the cost of cuts. Sacking 725,000 people at £25,000 each, even after allowing for the additional costs of employing these staff, will not save more than £25 billion of government spending. That leaves at least £35 billion of cuts to be made elsewhere. The only options available to achieve that level of saving are to either reduce benefits (and since almost all benefits are spent almost immediately upon receipt within the private sector this actually effectively means imposing a direct cut on private sector revenues within the economy) or that same private sector will receive a direct hit by having its extensive contracts with the government cut in value.

Whichever way this is looked at the result is not less than £35 billion will fail to reach the private sector as a consequence of government cuts (and this is before the effect of reduced spending by the former 725,000 public sector employees, now unemployed, is taken into account). Of this sum about 15% will be profits, which will be foregone. Maybe 20% will be investment, which will be foregone, resulting in job losses. The rest will be represented by direct job cuts. In other words about £23 billion of jobs by value will have to be cut – and at UK average earnings after allowing for the additional costs of employment and for wages being paid on average at the average rate of £25,000 per annum, that means a little over 750,000 additional private sector job losses on top of those already suffered in the state sector – exactly as forecast above.

The impact of the reduced spending of formerly employed people, now unemployed, could only exaggerate, and not eliminate this trend towards increased unemployment occurring. The likely fall in investment also increases the probability of cuts, and is not taken into account when achieving the estimated total unemployed figure suggested here. In other words, if there is any calculation error in these estimates it is to underestimate likely unemployment.

What can be done about this?

There are three things that can be done to prevent this disastrous scenario developing.

First of all the programme of cuts that has been announced can be halted before a tidal wave of unemployment is unleashed on the UK economy – none of which, because of tax revenues lost and additional benefits paid, will actually in any meaningful way reduce the UK government deficit.

Second, the UK government can and should be promoting new investment in the world economy – as was agreed upon by the G20 earlier this year.

Lastly the UK government has to promote demand in the UK economy, but in a way that is sustainable and economically justified. This is the basis for the Green New Deal^{viii}, which is the most timely economic plan the UK government could now adopt.

ⁱ http://en.wikipedia.org/wiki/Structural_deficit

ⁱⁱ <http://www.ifs.org.uk/pr/obr0610.pdf> page 3

ⁱⁱⁱ http://budgetresponsibility.independent.gov.uk/d/pre_budget_forecast_140610.pdf

^{iv} <http://www.statistics.gov.uk/pdfr/qna0609.pdf> table D

^v <http://www.statistics.gov.uk/cci/nugget.asp?id=285>

^{vi} http://business.timesonline.co.uk/tol/business/industry_sectors/public_sector/article7147171.ece

^{vii} <http://www.statistics.gov.uk/cci/nugget.asp?id=12>

^{viii} See <http://www.neweconomics.org/projects/green-new-deal>