

# Money is always around, but those in whose pockets it resides change from time to time.

Gertrude Stein—in Britain, in recent years, the public sector has had a very good run; time for a change!

The coalition partners are now fiscal conservatives.

George Osborne's first Budget was aimed principally at reducing Britain's borrowing requirement. The argument that it was premature to do so was discounted. The Chancellor thought that a yawning deficit would do more to undermine activity than excessive spending to sustain it.

Not by inclination, but by fear of replicating Greece!

Greece had demonstrated the actual problem; Spain, Portugal and Ireland the potential risks. It was the intention of the new Government not to fall into trap that had ensnared them. The economy would be rebalanced over the course of the next Parliament. To this end, resources would be taken from the public sector (where they'd yield very little) and made available to the private sector (where they'd be likely to produce much more).

Public spending will be cut; public employees sacked.

It was not just a question of finance; it was one more importantly of labour. There'd be no more recruitment into the public sector; there'd be dismissals instead. Pay levels would be frozen for a while. And, belatedly, very belatedly, the scandalous indulgence of public sector pensions would be tackled.

Will there be riots in the streets? Very unlikely.

In Greece and Spain, such measures had provoked civil unrest. Would they do so in the UK? Probably not. In the one, democracy had been abandoned, in the other respected. In the EZ, changes in policy had been imposed by external *dictat*. In Britain, by internal *consensus*. In the former, the will of the national government had been ignored. In the latter, effected.

The only tax that'll yield significant extra revenue is Vat.

On taxation, the Chancellor mostly kept things as they had been. He did, however, hike GCT sharply (a concession to left-leaning Libs) and he did increase VAT substantially (the lure of extra revenue being irresistible). He may come to regret the latter change. It seems to be relatively easy to defraud the authorities of the duty that's owed to them. Accordingly, now that the yield from doing so is much higher than it used to be, it's possible the problem'll become more widespread.

Will the strategy work?

Will the Budget achieve its goals? Will the economy be rebalanced, and public finances concurrently improved? The jury is out. Changes in taxation and spending are of minor significance in relation to variations in the growth of GDP. It's the latter the Chancellor has to worry about not the former.

Only if GDP holds up.

If growth should be reasonably brisk, tax collections would rise and benefits transfers subside. In such circumstances, the deficit would shrink regardless (almost) of any fiscal adjustments that had been made. Similarly, if the economy were to collapse (as Greece's threatens to), the deficit would soar, and nothing the finance ministry had done, neither the spending cuts nor the tax hikes, would make much difference!

The Chancellor must eliminate impediments to growth.

In 1815, in the immediate aftermath of the Napoleonic wars, Britain's fiscal deficit amounted to about 25% of its GDP. But the red ink disappeared rapidly in the next several years. And not because taxes were raised; on the contrary, they were reduced. How so? Public spending was cut (as soldiers were demobilised) and business activity soared (as Continental ports, which Napoleon had closed to British shipping, were reopened).

Not easily done when the banks are in trouble again.

So, what are the prospects for the economy in the next year or so? Not very good: the clearing banks are still in a parlous state, it transpires. In a report published last week, the BOE drew attention to their loan books. The huge transfusion of taxpayer support hadn't resolved the problem: delinquency remained widespread. Too much money had gone into featherbedding executives, too little into rebuilding balance sheets.

Their capacity for misjudgment seems unlimited.

And the European crisis hasn't helped. Predictably enough, the Scottish banks were found to have had huge exposure to all the worst risks. And the losses resulting from their incompetence have now been transferred to the English taxpayer. Brown and Darling have a lot for which to answer!

And is the US economy coming off the rails?

Perhaps most worryingly of all, Bernanke is fretting about the outlook for the US economy. He's looked at recent numbers, he's analysed business cycle data, and he's concluded that the economy might revert to unsatisfactorily slow growth next year, very possibly dip back into recession. If so, there'd not be much he could do. Like Custer, when he'd run out of ammunition, the end would be as inglorious as it was inevitable.

If Bernanke's worried, so ought we to be.

How will security valuations fare in conditions of widespread economic retrenchment? They may hold up surprisingly well. If pay settlements (especially public sector ones) take a disproportionate share of the pain, inflation will be low and profits satisfactory. Set that in the context of easy money and the indices are likely to advance.

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