Osborne seeks route to election victory as UK teeters towards a new economic crisis

December 2, 2014 1.59pm GMT

David Blanchflower
Professor of Economics, University of Stirling

Britain's chancellor of the exchequer will aim to deliver an election-winning financial package on Wednesday. But he will effectively have one arm tied behind his back.

It wasn't meant to turn out this way. In his Mais lecture, given in February 2010 George Osborne claimed:

The recovery will only be sustainable if it is accompanied by an internal and external rebalancing of our economy: in other words a higher savings rate, more business investment and rising net exports. So we will maintain the AAA credit rating. We will increase saving, business investment and exports as a share of GDP.
So far so bad.

As Osborne prepares his Autumn Statement the public finances aren’t in good shape and deficit reduction has stalled. The coalition has borrowed even more than Alastair Darling planned. Income tax receipts are considerably worse than forecast. Government debt as a share of GDP is above the EU average. The AAA credit rating is gone.

There has been no rebalancing away from financial services to manufacturing; there has been no march of the makers, no sustained move towards a trade surplus and investment fell recently. Savings are down. Plus, there is another government-induced unsustainable housing bubble, with house price to earnings ratios at the same level they were in 2005, and rising.

The Bank of England’s Monetary Policy Committee (MPC) can’t raise interest rates because of fears it would wipe out mortgage holders and probably require more bank rescues. The UK is unprepared for a shock. But it is inevitably coming. They turn up every seven or eight years – and the next one is soon due, with the MPC lacking the room to cut rates as we did in 2008. Things are looking ugly.

Austerity errors

Living standards have fallen more than in any previous parliament in recorded history. Jobs are up but real wages are down around 8% since the coalition took office. Real wages are up for those in continuous employment but sharply down for those who obtained their jobs since 2010. The combination of the underemployed and the unemployed means there is a massive amount of labour market slack, equivalent to an unemployment rate of at least 8%, pushing down on wages. In addition a further 1.5m million workers from Eastern Europe already have National Insurance numbers and their potential entry is keeping wage growth down. The average person doesn’t feel any recovery.

The UK economy experienced a once-in-a-hundred-year shock that lowered GDP rapidly over a period of five quarters in 2008 and early 2009. Then the economy started to recover steadily, at the same pace the economy has traditionally recovered in all prior recessions at least over the last century. Economists sometimes call this “escape velocity”. Then along came George Osborne and the coalition with their reckless austerity, aided and abetted by Mervyn King, talking down the the UK economy and falsely claiming it was bankrupt and like Greece, Spain and Portugal, which don’t have their own central banks or currency. Hey presto… the recovery disappeared.

Business and consumer confidence, that fragile factor that Keynes called “animal spirits”, collapsed at the end of 2010 and growth stalled. Raising VAT and slashing capital expenditure were obvious mistakes that were large contributors to the subsequent three years of flat-lining.

Eventually, after easing off on austerity, the economy started to grow again and in the past year or so has grown at approximately the same rate it was growing when the coalition inherited the economy. This has been the third-worst recovery in 650 years behind only the Black Death and the South Sea Bubble. This has been the slowest recovery in 300 years.

Worryingly, the UK is slowing again. Despite claims to the contrary by the coalition, the UK isn’t the fastest-growing country in the G7. The US grew faster than the UK in four of the past five quarters, two of the past two and one of the past one. It is true that the UK grew faster over the past 12 months, but that is because the US experienced a terrible winter at the beginning of 2014.
UK manufacturing is looking fragile. Investment has stalled. Consumers continue to run down their savings and take on debt. The balance of trade is worsening. Business and consumer sentiment has slowed. Wage growth shows no sign of picking up and the housing market seems to be past its peak.

Apparently, the Autumn Statement will add some much needed money to the NHS, which disproportionately helps the old, who tend to vote. Austerity failed and there are masses more cuts to come. And now for the good news...