The crisis and the deficit

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Q. Are cuts in public services, welfare benefits, and public sector pay, jobs, and pensions unavoidable?

A. No. In the first place, there is nothing impossible about the government continuing with a large budget deficit for a while.

In the second place, the Trident replacement (maybe £30 billion) could be cut. Military spending (total £37 billion a year) could be reduced. The vast administrative costs of the internal market in the health service and the payments to private contractors under PFI schemes (up to £10 billion a year) could be axed.

In the third place, the deficit could be reduced by taxing or confiscating the huge wealth of the rich. Remember, inequality of wealth and after-tax incomes has spiralled since 1979, and continued to increase under New Labour.

Q. But none of those options will convince the Lib-Tory government.

A. The only thing that will convince the government is fear. Governments run huge budget deficits during and after wars because they fear military defeat or post-war upheaval more than the economic difficulties of budget deficits.

Q. How do we frighten the government?

A. Nick Clegg has already told us, when before the election he announced his fear of "Greek-style unrest".

Q. One-day strikes, then?

A. And more. The Lib Dems and Tories take Canada in the 1990s as a model of how to cut. Canadian workers organised a series of one-day local general strikes in protest, culminating in a strike which stopped Toronto in 1998. But the union leaders stopped there. We will need open-ended strikes, strikes where workers take action until the government backs down.

Q. That's impossible because of the anti-union laws.

A. The engineering construction strikes of 2009 broke the anti-union laws, but neither the bosses nor the government dared use the laws. Action on a sufficient scale can defy the laws. We can't do that tomorrow. We can start mobilising, agitating, and organising in local anti-cuts committees. There are already strikes and demonstrations against cuts in Greece, Italy, Spain, Germany and other countries. Those actions will encourage mobilisation in Britain, and mobilisation in Britain will help mobilisation in other countries.

Q. If the government doesn't make cuts, it will lose credit in the international financial markets. It will have to pay higher interest rates to sell the bonds with which it finances its week-to-week spending. It will end up like Greece.

A. It won't do that straight away. And if workers all across Europe force governments all across Europe to back off from cuts, then the exchange-rate of the euro and the pound against the dollar may fall, but the international financiers are unlikely to desert European bond sales. But, yes, in the longer term, a government flouting neo-liberal norms would see a spiralling crisis where international financiers demanded higher and higher interest rates to buy its bonds, or would not buy them at all.

Q. And then what?

A. Take over the whole of high finance, and put it under public ownership and democratic control! The free movement of finance across borders would have to be blocked, not in order to create a walled-off national economy but in order to seek new forms of cross-border collaboration governed by cooperation and solidarity between workers' movements in different countries.

Q. This Lib-Tory government won't do that.

A. As well as resisting the government and its cuts, we need to fight for a *workers' government* — a government based on, accountable to, and serving the labour movement.

Q. You mean another Labour government?

A. Not another Labour government like the Blair-Brown one! Immediately, the battle is to win unions to working-class policies, to a commitment to fight politically for their policies, and to the principle of working-class political representation.

That includes a fight in the Labour-affiliated unions to win — in the review of Labour Party structure due to open in October 2010 — democratic control over the Labour Party leadership by the union and local Labour Party delegates at Labour conference.

To what extent that battle can force changes in the Labour Party, and make a future Labour government carry out measures which serve working-class interests, and at what point it might force a break, where the Blair-Brown New-Labourites split away rather than accept accountability, we will see.

But the political battle for the aim of a workers' government, and for the working-class policies it should carry out, starts now.

Q. Why is the Lib-Tory government so keen to pay off the government debt?

A. The government is not paying off the debt. On its projections, government debt will be bigger in 2015 than it is now. What they plan to do by 2015 is to squeeze out the "structural deficit".

Q. "Structural" means what?

A. It means the part of the gap between government income and spending which is "structural" in the sense that it would exist even in relative boom times. The other part of the gap is temporary deficits which more or less automatically heal with economic recovery. Those are caused by incomes and sales, and therefore tax revenue, being temporarily lowered in recession.

Q. All mainstream economists reckon it's necessary to

squeeze out the "structural" deficit, don't they?

A. Yes and no. No government in a money economy could run a big permanent budget deficit, year in year out, slump-time or boom, unless it enjoyed a constant flow of foreign wealth-holders lending it more and more money, as in effect the USA does. If a British government tried to run a big permanent budget deficit, it would suffer serious inflation and a collapse of the exchange rate of the pound. But the Lib-Tory government plans go way beyond recognising that constraint.

Q. How?

A. First, it's guesswork how much of the government budget deficit is "structural" and how much is temporary. More optimistic figures for future growth would give you a smaller figure for the "structural deficit".

Second, governments can narrow budget deficits by cutting spending or by raising taxes. This government plans to do it almost entirely by cutting spending. It plans to cut some taxes, while raising others.

Third, the government plans to cut the deficit quickly, in the midst of recession. It could instead wait, let growth reduce the deficit, and leave government budget adjustments to be calculated later.

Q. So the quick cuts are just a political choice by the government? There is no real economic constraint on the government to do them?

A. The Tories subscribe to an economic theory — advocated by writers like Jeffrey Sachs — which says that quick cuts will work better for capitalism.

Week to week, governments get cash for their spending by selling bonds — that is, bits of paper which entitle the owner to receive the face-value at a fixed future date, say in ten years' time, and meanwhile an interest payment every six months. They also sell bills, which are similar things, but shorter-term: they entitle the owner to receive final payment in a shorter time (usually three months), but no interim interest payments.

Of course the government constantly has to sell new bonds and bills, if only to make the final payouts on the old bonds and bills falling due each month. If it sells more new bonds than it pays off old ones, then it increases its debt; if it sells fewer, then it decreases it.

The Tories concede that they have to run deficits — sell more bonds than they pay off — for several years ahead. But they reckon that if they sell fewer new bonds than previously planned, then the interest rate they have to offer on bonds will be kept low. That will help keep down interest rates generally. Capitalist businesses will be able to get money to expand at a lower interest and more easily (because wealth-holders who would otherwise buy government bonds will buy corporate bonds or shares instead).

Q. Will it actually work like that?

A. It may to some degree. No-one knows. Obviously leftish economists are predisposed to highlight the mechanisms by which public-spending cuts depress the whole economy, and right-wingers are predisposed to highlight the chance of government restraint making better openings for private enterprise. But some right-wing economists, too, question the government's story. The *Financial Times* backed the Tories on election day, but its main economic writers, Martin Wolf and Samuel Brittan, are furious about the government's plans. They think that by cutting public spending now the government will also pull down private capitalist business, by way of reducing market demand for goods and services bought by the public sector, by public-sector workers, and by people on benefits. The US government also thinks the cuts policies of European governments are excessive.

Q. Why should the government go for something so unpopular when they have no basis for it but guesswork?

A. There are at least four reasons.

One: the Tories have a inbred inclination to believe the "right-wing" story and to relish a chance to squeeze public sector workers and unions.

Two: Angela Merkel's government has pushed through a £66 billion cuts plan on 7 June, and is pushing other eurozone governments to make similar cuts and commit themselves (as Germany did in May 2009) to constitutional amendments banning budget deficits except in emergencies.

Germany has no real problem of excessive deficits or difficulties in selling bonds at low interest rates. Merkel's choice is a political choice, for a neo-liberal rather than a state-funded way forward from the crisis. It prioritises sustaining the international exchange rate of the euro and making the eurozone a "disciplined" economic environment to attract footloose global capital. Merkel is anxious to "offset" the 750 billion euro rescue package agreed in May for debt-laden south European states (or, more to the point, for the German, French, and other banks to which south European governments and businesses owe debts).

The French government is demurring a bit, and possibly within a year or so the debt crisis of the south European states will force the eurozone into new "bail-out" policies; but for now Merkel is setting the tune for the eurozone. That puts competitive pressure on the British government.

Three: the fact that the government is a coalition puts pressure on its leaders to be quick about getting all the unpopular measures agreed and under way (some cuts will take years to produce large savings in government cashflow).

Once the Lib Dems have been "bloodied" by supporting the Tory cuts plans, there is strong pressure on them to stick with the coalition government for several years. By the next election they can hope that anger at the cuts will have faded and the coalition parties can claim credit as people who did what was painful but necessary. If they break from the coalition earlier on some secondary matter, they face double censure as having collaborated in unpopular measures but lacking the fortitude to see them through.

Four: the Tories' talk before the election about "restoring responsibility" (as they put it) to government finances tie them now.

A government which repeated soberly that it saw no immediate problem and it would adjust in due course might be ok. A governing party which raised an alarm about budget deficits, then made no cuts, would alarm the international financiers to whom the government sells bonds.

Merryn Somerset Webb put it bluntly in the *Financial Times* just before polling day, advising capitalists: "If you don't see the slash-and-burn coming within weeks of the election, you might want to move spare cash out of pounds".

Once the international financiers are alarmed, then it is harder for the government to sell bonds. The interest rates it has to offer rise. Its future financial projections look worse. A vicious spiral of alarm damaging the government's credit, and the damage to the government's credit in turn generating more alarm, can develop, as it did for Greece after its October 2009 election.

Q. So governments are at the mercy of international financiers?

A. Today's huge, fast-moving, global financial markets, where trillions flow across borders every day, can cripple governments very quickly.

Q. So we can't do anything against the cuts short of defeating the whole of global finance capital?

A. Even this government could be pushed to cut military spending rather than social provision. At present the military machine, and industries dependent on military contracts, are a more powerful lobby against cuts in their area than the labour movement is against cuts in ours. We could change that.

Q. And we could push the government to tax the rich rather than cutting social provision?

A. Up to a point. It would be demagogic to say that "tax the rich" is a sufficient alternative to the government's plans. We want to tax the rich. In fact we want to confiscate their wealth for the common good. But a government heavily taxing the rich would suffer a flight of capital as much as or more than one running an excessive budget deficit. The only answer to the power of global finance is to get workers' governments which will take over high finance, put it under public ownership and democratic control, stop the free flow of capital across borders, and create new forms of cross-border economic ties based on working-class cooperation and solidarity.

Q. Why do governments run debts? Why do they sell bonds? Why don't they just print money when they're short?

A. It is true that governments can't "run out of money" in the same way that households or businesses can. In the last analysis the question "where can the government get the money from?" can be answered simply: from the Bank of England printworks.

But constantly printing money whenever spending runs ahead of tax receipts would lead to uncontrollable inflation.

Selling bills and bonds from week to week — and having the Bank of England buy back some bills and bonds if it wants to get more cash into the economy — is the standard way of regulating money supply.

The system of government bills and bonds offers many advantages for the fine-tuning of government budget and monetary policy. But it wasn't invented for that. It started with governments scrabbling to raise cash for wars, and evolved into an organic and central part of the financial system.

As Doug Henwood explains: "A large, liquid market in government debt with a central bank at its core is the base of modern financial systems". "Liquid" means that the bonds can be bought and sold easily: there are so many in circulation that you can always find buyers and sellers. According to Henwood, in the USA and Britain, financiers hold on to government bonds for an average of only one month before selling them again.

Who exactly holds all the £900-plus billion of UK government bonds currently outstanding is hard to say, because they change hands daily. And, monthly if not daily, old bonds come up to their final pay-out dates, and new bonds are sold.

Once the system is going, a government is obliged constantly to sell new bonds, if only in order to make the payouts on the old bonds.

As Henwood notes: "Public paper... provides rich underwriting and trading profits for investment bankers and interest income for individual and institutional rentiers... Government debt not only promotes the development of a central national capital market, it promotes the development of a world capital market as well... Public debt is a powerful way of assuring that the state remains safely in capital's hands. The higher a government's debts, the more it must please the bankers". ("Wall Street", p.22-3).

Q. Why doesn't the government solve its deficit problem now just by taking back from the banks, bit by bit, the money it handed out to them in 2008?

A. In 2008 the government helped the banks to the extent of £1100 billion — £18,000 for every child, woman, and man in the UK.

But that does not mean that there is £1100 billion sitting in bank vaults and the government could solve its problems, or alleged problems, about selling its bonds on the global financial markets by "taking back" bits of that stash instead.

A lot of the £1100 billion consisted of guarantees and credits designed to get the banks trading with each other again by saying that if a trade went bad, then the government would help out. Those guarantees and credits do not exist as a lump of cash that can be "taken back".

Some of the money was spent on buying out banks — Northern Rock and Bradford & Bingley completely, and Lloyds, RBS, and HBOS partially. The government could sell the shares it holds in those banks. But it wants them to be healthier before it does that.

Some of the government deficit is due to the 2008 bailout, but that is essentially, for now, money which has disappeared into a black hole. Another part is due to tax income having shrunk in 2008-10, without public spending having shrunk.

The whole of high finance should be taken into public ownership, and without compensation to the big shareholders. Pending that, banks and bankers should be taxed more highly.

But neither of those measures is an easy, short-cut way for the government to improve its position in the global financial markets. On the contrary, they are measures towards defying and breaking the power of those global financial markets.

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