

The Political Mystery Surrounding Jeremy Corbyn and the UK Budget Deficit

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Let me confess, I am now confused as to what Jeremy Corbyn's policy is on budget deficits, their causes, impacts and remedies. Two weeks ago, I thought I understood what he was saying, and was mainly supportive of his approach. Now those speaking on his behalf (I assume) have made things a lot less clear, and probably a lot worse. They seem to want to swallow Osborne's deficit poison pill, but also to spit it out. This doesn't work.

Corbyn's deficit policy - via John McDonnell

On 11th August, the Guardian's "Comment is Free" section [published an article by Labour MP John McDonnell](#) headed "Jeremy Corbyn would clear the deficit - but not by hitting the poor". So far so maybe OK. But he goes on to say:

Let's see if, at least on economic policy, we can return to some level of rational debate. Let's start by tracing out *where there is absolute agreement*.

First, it is unarguable that no modern party leader can win an election if behind in the polls on economic competence. Ed Miliband, sadly, was proof of this truism. Second, *deficit denial is a non-starter for anyone to have any economic credibility with the electorate*. This was a key finding of the poll recently published by Jon Cruddas, examining why Labour lost the election.

So let me make it absolutely clear that *Labour under Jeremy Corbyn is committed to eliminating the deficit and creating an economy in which we live within our means*. [my emphasis].

Rational debate? No way - "deficit denial"... "eliminating the deficit and living within our means" - these phrases are straight out of the George Osborne "My greatest political hits" songbook.

But clearly John McDonnell was not speaking out of turn, for on the Today programme this morning, up popped Ken Livingstone to defend Jeremy Corbyn - and his first line was also to talk about getting rid of the deficit.

Intermezzo - governments are in no way like households

Underlying much of the political discourse is the flawed analogy, "the government is like a household". So Let's get the following basic points out of the way:

- The government is not like a household, whose members can ultimately be made bankrupt, or lose their home if the mortgage or rent is not paid
- The government is not even like a local authority (e.g. the former Greater London Council which Ken Livingstone and John McDonnell once ran), which has a legal duty to balance its budget annually, whatever the impact
- Unlike a household, or indeed Eurozone governments like Greece, the UK government has its 'own' central bank that uses monetary tools (including e.g. low interest rates and QE) to support both the private and public sectors of the UK economy
- Unlike a household, the government has almost guaranteed income in the form of tax revenues; these may fluctuate, but unlike a private firm's income from sales etc., payment is a legal duty
- Unlike a household, a government cannot be 'liquidated' - it cannot go bankrupt - so while it may get in difficulties for a while, it cannot be 'liquidated' in the way a company can.
- Unlike a household, the government cannot control its deficit, which rises or falls depending not just on its own acts and decisions (as with individuals), but largely on the health of the rest of the economy
- Unlike a household, the government has overarching responsibility - which it cannot shirk - for the well-being and security of *all* citizens (including future citizens), not just its own "family and friends" or a set of selected charities

What Corbyn has said

Back to Messrs McDonnell and Corbyn. Let me concede, you don't need to run a current budget deficit in years when the economy is doing well - though it is not likely to be a problem if you do have a modest current deficit if the economy is doing well.

There is however a strong political and economic argument for always treating borrowing for long-term investment, which benefits future generations, separately from current expenditure.

This is a distinction that Jeremy Corbyn is well aware of, and stoutly defended in his policy document, ["the Economy in 2020"](#). In a recent [PRIME article](#) "What the Labour leadership candidates say on macroeconomic policy", I quoted this passage:

We all want the deficit closed on the current budget, but there was no need to try to do it within an artificial five years or even the extra five years George Osborne mapped out two weeks ago.

If the deficit has been closed by 2020 and the economy is growing, then Labour should not run a current budget deficit - but we should borrow to invest in our future prosperity.

You don't close the deficit fairly or sustainably through cuts.

You close it through growing a balanced and sustainable economy that works for all. And by asking those with income and wealth to spare to contribute more.

If Osborne's forecasts are right there won't be a deficit by 2020, but if - like last time -

he is proved wrong and he only again manages to halve the deficit then I make this pledge:

Labour will close the current budget deficit through building a strong growing economy that works for all. We will not do it by increasing poverty...

Rather than remove spending power from the economy and damage growth and future prosperity, Britain needs a publicly-led expansion and reconstruction of the economy."

This is a very different tone from the "living within our means" meme in John McDonnell's piece - and rightly argues that developing "a balanced and sustainable economy that works for all" is the only progressive and sensible way to deal with (eliminate!) current budget deficits. Moreover, he makes clear that borrowing for investment is part of his positive policy for building "a strong growing economy".

The multiplier

The reasons for this are evident - it's our old friend the multiplier. When times are bad, cuts in spending on public services (or major increases in taxation) reduce the size of the economy by more than the size of the cut, because of the knock-on effects in terms of loss of spending power of those made unemployed, plus the cost of an increase in unemployment benefits - the negative multiplier.

But when the economy is not fully productive, increases in publicly-supported investment (much of which will be implemented via the private sector) tend to provide more decently-paid jobs, paying more taxes, and reducing the cost of social security benefits. The workers thus employed buy more stuff, leading to more employment and production... And society ends up with new bridges, or railways, or energy-efficient buildings, or a universal fibre-optic network...The financial benefits (including knock-on economic effects) to the public purse outweigh the cost. This is the positive multiplier at work.

Let us note too that Liz Kendall - seen by many as the most right-wing candidate of the four - [has argued](#) that deficits are indeed sometimes necessary:

"It is also true that countries are not like households. Sometimes, in some years, governments need to run deficits. If Britain had not run a deficit at the start of the financial crisis the social and economic costs would have been much higher."

As we have pointed out before the UK has very rarely, since at least 1960, NOT had an overall budget deficit. But for much of this period the debt to GDP ratio fell or was stable because the borrowing did not exceed the rate of expansion of the economy. So "living within our means" - if by that one means having an overall balanced budget - does not mean never having an overall deficit. Far from it.

Tackling the deficit

John McDonnell combines two very different strands of "deficit tackling" in a single sentence, which to my mind confuses the issues:

We don't believe that the vast majority of middle- and low-income earners who didn't cause the economic crisis should have to pay for it through cuts in tax credits, pay freezes, and cuts in essential services. Instead we believe we can tackle the deficit by

halting the tax cuts to the very rich and to corporations, by making sure they pay their taxes, and by investing in the housing and infrastructure a modern country needs to get people back to work in good jobs.”

First, if, for example, you aim to get rid of a 3% deficit in a single year in this way, tax income from the rich needs to rise by more than the same amount, i.e. around £60 billion.

Not all of this sum would reduce current year private sector spending in the UK (we don't adhere to trickle-down economics!) but undoubtedly some of it would do so, and is therefore somewhat deflationary, and acts as a negative multiplier.

(This point is independent of the positive role of tax justice as an instrument of social policy, as an issue of justice and for diminishing wealth and income inequality – not mainly for instant deficit-crashing, since tax increases can have a bad economic impact (recall the recent VAT increase in Japan as part of Abenomics). If tax rises diminish economic activity, the deficit will – perversely – rise.)

Second, the investment programme added here as a deficit-tackling instrument does not (in the short term) “save” money, but spends it – for good reasons. The financing can be by borrowing, but if so, the borrowing counts towards the overall deficit which may therefore tend to rise initially! The positive multiplier expected from the investment will give benefits in future years, not in year 1.

Carney on the “bridge-building” role of deficits

For why be so coy and defensive? Even Bank of England Governor Mark Carney is clear about the need for public deficits in difficult times. In a [speech in Dublin](#) on 28 January 2015, he pointed out that

In the decade before the crisis, private financial balances became unsustainable...

Yes, *private* finances... He went on

The UK had the space to allow its automatic stabilisers [i.e. benefits etc.] to cushion the impact of the recession. With the deficit rising to a peak of more than 10% of GDP before steadily consolidating, fiscal policy effectively recycled elevated private savings and built a bridge to the period when private balance sheets were repaired and confidence returned.

That is, the public deficit is a function of the overall state and balance of the economy as a whole, not a thing-in-isolation. UK public debt in 2007/8 was just 37% of GDP, and the current budget deficit 0.5% of GDP. Borrowing for capital investment was 2.2% of GDP. Yet the financial crash occurred, for reasons quite unrelated to public debt and deficits.

In defence of deficits

Maybe I have misunderstood something in all this. Maybe “living within our means” – for Messrs McDonnell and Livingstone as well as Corbyn – is to be understood and treated as a longer cyclical issue, covering a span of years, so that deficits in bad times are still okay. Maybe it is intended that references to “eliminating the deficit” should really be understood as “eliminating the current deficit”. Maybe it is agreed that borrowing for long-term investment is acceptable even though it may create an equivalent “deficit” .

In which case, they should make this clear, and not dress up key points of policy in the linguistics of the radical right, nor hide the actual policy behind their veil.

It may be politically hard to make this case for the positive role of deficits – in many circumstances – with a public who have for so long been lectured by Very Important People from the Conservative, Liberal and Labour parties that deficits are *by nature* lethal, and There is No Money.

But if even politicians of the left come to adopt language and arguments that underpin Osbornian politics – and are constantly preached from the neolithic (pre-Keynesian) cult temples of classical economics – we are lost in a new Dark Age.

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