THE UK AUTUMN FINANCIAL STATEMENT.
Optimistic days are here again[1].

Sunak's budget presentation on Wednesday was not so much a presentation by a chancellor as by a cheer leader. Not one word of green was mentioned. It was a presentation spiced by hyperboles, and the word 'optimism' and 'optimistic outlook' abounded. One wonders why the Chancellor needed to raise the morale of his party and the country if things were so self-evidently good. Sunak behaved like a swimmer who had escaped a large wave, who then turns around to jubilantly salute the adoring folk on the beach, only to be hit by another wave and forced to swallow his words.

Johnson and Sunak are ploughing a different fiscal path to Cameron and Osborne. Whereas the latter concentrated on cutting government spending the former are raising taxes to support increased government spending. The tax burden is set to rise from 33.5% of GDP pre- pandemic to 36.2% of GDP by 2026-27. This will be the biggest tax burden since the early 1950s. This rise of 2.7% represents a much bigger burden on wages, even adjusting for corporation tax rises, because wages represent only 63% of GDP.

The tax burden on wages will thus be more like 4% by 2026. This is confirmed by the £3000 increase in taxes estimated by the Resolution Foundation by 2027. And even this underestimates the tax burden given the effect of VAT on inflation. Assuming a 4.4% inflation rate next year as set out by the Office for Budget Responsibility 2021 Outlook, VAT will raise an additional 0.9% in tax (4.4% on 20% VAT = 0.9%). Sunak made a big play about not raising fuel duty. He could afford to do this because the increase in the VAT-take on fuel rose to 24p from 20p per unleaded litre (December 2019), because of the jump in retail petrol prices to £1.44 per litre. https://www.gov.uk/government/statistical-data-sets/oil-and-petroleum-products-weekly-statistics

This increase in overall tax proposed will enable a 3.3% inflated adjusted increase in public spending amounting to an additional £22.9 billion annually up to 2026-27. Much of this will be front loaded to be spent in the next fiscal year. This will raise the share of output commanded by the state from 39.8% of GDP pre-pandemic to 41.6% in 2026-7 a level comparable to the late 1970s. This has led commentators to compare Johnson and Sunak to Blair and Brown, rather than Thatcher and Howe.

Johnson claims that this increase in public spending means the end of austerity. But austerity has many facets. In its complex form it comprises take home pay plus the services government provides workers. Together they make up workers' standard of living. Should it be the case that both pay and services rise, then clearly a compounded rise in workers' standards of living occurs. Should only one rise while the other falls, then depending on whether the rise on the one side is greater than the fall on the other, standards of living will continue to rise. However, if the fall is greater on one side or both fall then clearly standards of living will fall.

Sunak claims that his increase in departmental spending will improve services to workers. However, much of this increase will be consumed by healthcare costs and social care. Most of the rest of the services provided to workers both unemployed, employed, and pensioned, is provided by the DWP and local councils. Despite marginal improvements up to 2024-5, DWP spending will still be down 26% on 2009. (Figure 18, page 23) https://www.resolutionfoundation.org/app/uploads/2021/10/The-Boris-Budget.pdf

The Institute For Studies whose analysis on local government is the better, states that over the same period scale, local spending will not actually increase. "*One area that may still face a bit of a struggle is local government. Despite a real increase in spending power, tighter limits on what can be raised in council tax****, the fact that grants are being frozen after next year****, a continued failure to update funding formulae, and the demands of the social care system, could still see some local authorities having to cut services over the next few years.* [*https://ifs.org.uk/budget-2021*](https://ifs.org.uk/budget-2021) In translation what this increase in 'spending powers' means is that any real term increases of up to 3% in local council spending will have to be funded by raising local council taxes by up to 5% and not from government grants which have been cut by two thirds from 2010 levels. It is worth pointing out that council tax now raises four times as much as corporate tax. No local loopholes then!

I was considering sub-titling this article as WOKE AND MIRRORS instead of OPTIMISTIC DAYS ARE HERE AGAIN. Certainly when it comes to local council spending and the recycling of old money as new, the Chancellors' presentation was full of smoke and mirrors. Equally, when hardship erupts this winter, Johnson is likely to try and divert anger with culture wars both here and against newfound enemies like the French. Woke will be in vogue once more. Most probably Johnson's last thoughts at night is, why oh why won't the Argentinians invade the Falklands again, ah well, there is always the Russians or the Chinese.

The Resolution Foundation points out that wage growth is the slowest since the 1930s. They point out that in the 16 years leading up to 2008 wages grew by 36 per cent on average, compared to only 2.4 per cent in the 16 years up to 2024. This projection is difficult to reconcile with the OBR seeing a real 1.7% fall in wages in the second half of this year and the IFS seeing the median wage falling by £180 next year. My own estimate is that by 2024-5 the average standard of living will fall by 5% not rise by 2.4% compared to 2008 given inflation, tax rises and adjusted for service provision. All it will take to achieve this number after factoring in the 4% tax rise, will be for wages to trail inflation by 2% over this time. And of course by 2024-5 we can anticipate a real term fall in services as the treasury struggles to balance the books.

Therefore, unlike the prancing chancellor in front of his breying audience in a crumbling palace, workers have no cause to be optimistic about their future.

Universal Credit.

Both the IFS and the Resolution Foundation agree that the benefits of the budget, if there are any, will be located in the bottom 20% of society and the top. This is debatable. The bottom 10% or at least half of the bottom 20%, will suffer dreadfully. The loss of the £20 a week in UC support is cruel. Let us be clear, this is not a £20 cut it is a £30 cut because of inflation. Not only should the government have kept it, but it should have increased it to take account of inflation which bears down most heavily on the poorest because they spend proportionally more on food and heating. And as I pointed out before, the £20 uplift only made good the losses suffered by claimants because of the previous four-year benefit freeze.

The reason the Tories removed the uplift was part of a cunning plan whose other two parts were the rise in the minimum wage and the reduction in the UC taper from 63% to 55%. This is the stick and the carrot. Its purpose is to open up a gap between benefits and pay and to increase the desperation of those out of work. In short to compensate for the shortage of cheap Eastern European workers, well, by turning the unemployed into East European type workers and fostering internal migration. That is what taking control means, controlling and tormenting the unemployed by driving them into work, any work.

The Outlook.

The OBR estimated a current £55 billion windfall for the exchequer based on the divergence of the March and October outlooks with the October outlook having improved. A bit like going to the doctor to check whether you broke your ankle only to find out that you sprained it. Not good, simply less bad.

Of this £55 billion the chancellor has spent half. But is this windfall real? Is the October outlook actually better? Looking at the table below this seems problematic. The difference below of 0.03% translates to under £7 billion or £19 billion when factoring in National Insurance increases, not £55 billion.

Table 2.4: The short-term quarterly GDP profile

	Q1	Q2	Q3	Q4	
March 2021 report	-3.8	3.9	3.0	3.3	total growth 6.4%
October 2021 report	-1.6	4.8	1.6	1.9	total growth 6.7%

(page 46 of the OBR report.)

So in the first half of the year growth exceeded expectations by 3.1%. In the second half it is expected to undershoot by 2.8% compared to the March estimates. This means that growth this year is now estimated to be 6.7% rather than 6.4% according to the earlier estimate. But note, in one aspect the October report is worse, because instead of accelerating, growth has been slowing. In March Q3 was projected to slow by 20% from Q2 now it is slowing down by over 60%. The ONS brought out its monthly GDP figures on the 15th October. In the first two months of the 3rd quarter namely July and August, GDP grew by 0.3% cumulatively. To achieve the 1.6% estimate in the October report, GDP must grow by 1.3% in September. A +1% monthly growth rate has occurred on only three occasions since June 2020, so it is unlikely.

It is worth adding in that the US has just announced its 3rd quarter GDP growth rate which at 2% fell well below estimates (and even this 2% figure is overstated because of dubious retail sales which I have pointed out). This brings into question the view that UK GDP will expand by 6.5% next year according to OBR projections. In fact the fourth quarter is going to be particularly difficult because that is the quarter when bad debts begin to bite, and spiking inflation, particularly energy costs, curbs household spending. https://www.bankofengland.co.uk/credit-conditions-survey/2021/2021-q3

This is what the Bank of England had to say as reported in the Financial Times. "*A third of the UK's small businesses are classed as highly indebted, more than double since before the Covid-19 pandemic, the Bank of England said on Friday as it warned of a likely rise in company collapses by the end of the year. SMEs were responsible for 2/3 of the increase in corporate amounting to £79 billion between 2019 and Q1 2021. A third of SMEs had debt equal to ten times their cash balances compared to 14 per cent before the pandemic."* https://www.ft.com/content/4f1da07c-1865-4ea3-9e01-cb70c9e3c246 One of the reasons the deficit reduced in the October report by the OBR was due to writing back bad debts for corporate loans and assistance. The fourth quarter will determine if reversing bad loan provisions has been premature.

The OBR has reduced its estimate for scarring from the pandemic from 3% to 2% enough to project that the economy will regain its pre-pandemic level by the end of the year. (Once again I am suspicious about this projection because both the ONS and the OBR have underestimated inflation.) In fact, the ONS assumed a deflator of -2.3% for the second quarter in determining real GDP growth. In other words there was deflation rather than inflation which is highly unlikely. They have held their estimate for scarring due to Brexit at 4%, making total scarring adding up to 6%. This is ominously close to the estimate that workers' standards of living will fall by 5% over the same period.

This slowdown in growth explains why the chancellor is front loading public spending. Despite the hyperboles he is aware that greater public spending is needed to compensate for weaker private spending. This is exemplified by investment predictions. The OBR expects business investment to fall this year as the table below shows then to jump next year on the back of tax handouts. Additionally, there will be a rise in government investments in capital projects. However despite this, the OBR in its executive summary estimates that gross capital stock will still be 1.6% lower in the medium term compared to before the pandemic. Not exactly the springboard for a high wage and high productivity economy.

Business investment

2020	2021	2022
-10.2%	-2.4%	15.7%

But even this assumption of a growth of 15.7% next year appears to be optimistic in the face of waning global production. In the case of the USA, which already reported it GDP, non-residential investment fell sharply in the 3rd quarter of this year.

Quarterly growth in non-residential investment.

Q1	Q2	Q3
12.9%	9.2%	1.8%

It is also worth pointing out that the Chancellor has pushed back his pledge to increase R&D spending to £22 billion annually from 2024 to 2026.

Interest rates, the elephant in the room.

Despite stating in May that its QE stance was unchanged, the Bank of England (BOE) has reduced its weekly purchases of gilts from £4 billion to £2 billion somewhat faster than the actual fall in the public deficit. Since Bailey made his August announcement of possible QE tightening, the markets have anticipated up to two rate rises this year in contrast to earlier views that the first would only happen in March next year. Thus the markets have pencilled in the possibility that the Bank's lending rate could hit 0.5% by the end of the year.

Regardless of what happens in the November Bank meeting of governors, banks and building societies are already beginning to raise their mortgage rates. This could cost mortgage holders up to £830 a year should rates rise by 1%. Add this burden to inflation and tax rises, and this will add to discontent, not optimism.

The decision or not to raise its interest rates does not lie solely in the hands of the governors of the Bank of England, but globally. Should the US FED raise its rates, the BOE will have no choice but to raise its rates as well to remain competitive and prevent a run on the Pound. While the Chancellor is aware that interest rates may rise, they play little part in his calculations. Should the independent BOE be forced to raise interest rates to 1% over time because of inflation and global reactions, then whatever windfall Sunak claims he has, will be washed away as this would cost the government over £20 billion annually.

The counter argument is that Britain has the longest-term government bonds in the G7 with average maturities of 13 years. So any rise in interest rates will have no immediate effect on raising interest payments currently standing at 1.1% of GDP. This however is only half the story. When the BOE buys Gilts from banks it exchanges them for interest bearing reserves held at the BOE, currently paying, you guessed, 0.1%. Any rise in interest rates will raise the interest payments on these reserves immediately regardless of the average term. https://www.reuters.com/article/uk-global-borrowing-idUSKBN2BW11E

It is for these reasons that central banks will be fighting a rear-guard action to prevent interest rates rising and if they are forced to raise them, to limit the rise. Financially the whole world is lob sided as a result of Western governments relying on financial remedies after 2008 to benefit the rich rather than fiscal remedies and higher taxation on the rich. They have created a ticking timebomb.

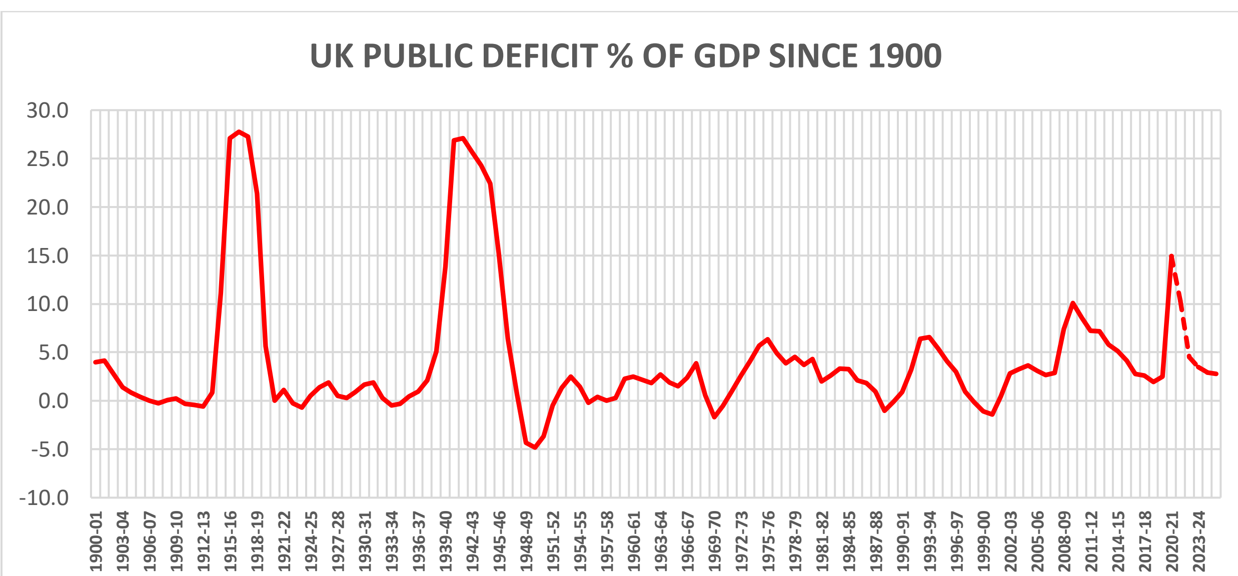
Why no green?

Sunak no doubt realised that it was going to be touch and go getting his Gordon Brown budget through. Most of the Tory MPs are fiscal conservative who are infatuated with small government and low taxes. A Brown and Green budget would have been a step too far, even when COP26 was imminent, and the world was watching.

No doubt when he was later cocooned with his back benchers following his breath-taking Commons performance he would have been assuring them this budget was but a temporary detour while the main Tory road was being resurfaced. No doubt he would have assured them that by the end of this parliament, government finances would be in good order and that tax cuts could begin again.

His projection is best captured in the form of a graph. By the end of the parliament, the deficit will allegedly be down to 2.8%, not far off the recent low point of 2%. This represents a fall of 12% which was only beaten once in recent times by the Labour Government after the war, and well it cost Labour the following election.

Graph 1.



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Conclusion.

Sunak will hope the same fate does not befall his government. But this is likely. Sunak's delivery would have made Marie Antoinette blush, but unlike Marie who did not have the help of a slavish media, he may have temporarily conned a number of voters with "his build back better we are over the worst" rhetoric. But his presentation was full of sleight of hand. In most cases only 20% of the money was new money. His only nod to a green agenda was all that recycled money he promised. He had the audacity to speak of 'world class services' when what we have is the world's most expensive privatised crap (excluding the NHS).

The problem for the capitalist class, as for any ruling class, is when reality does not measure up to the rhetoric. This is going to be the second hardest winter after the war. The hardest was the last one. No doubt the nurses and doctors in the NHS will be humming 'optimistic days are here again' as the NHS buckles. No doubt householders will be humming the same tune as they open their heating bills or when they walk around the supermarket avoiding the aisles they used to frequent, or when their shoes wear out, or when they see their children under-nourished. They are unlikely to be humming as insecurity and dread envelops them with its dark and cold hands.

Over the next two years living standards will fall significantly. In the end this is what austerity actually means. We must not allow Sunak and the soft-lefts with their narrow definitions, to claim it has passed. By 2024 sixteen years will have passed during which time the majority of society will have seen their economic circumstances deteriorate while their planet heats up and the super-rich steal everything not nailed down. No society can sustain itself under these conditions. It is capitalism not workers who need to pay for all this greed, ineptitude and short-sightedness. The only way to save a hot planet with a cold heart, is even hotter politics.

1. Sung to the tune of '*Happy days are here again*'.
   All together shout it now
   There's no one
   Who can doubt it now
   So let's tell the world about it now
   Optimistic days are here again.

Brian Green, 28th October 2021.