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# Pain of British Fiscal Cuts Could Inform U.S. Debate

By LONDON THOMAS Jr.

LONDON — In the United States, the debate over how to cut the long-term budget deficit is just getting under way.

But in **Britain**, one year into its own controversial austerity program to plug a gaping fiscal hole, the future is now. And for the moment, the early returns are less than promising.

Retail sales plunged 3.5 percent in March, the sharpest monthly downturn in Britain in 15 years. And a new report by the Center for Economic and Business Research, an independent research group based here, forecasts that real household income will fall by 2 percent this year. That would make Britain's income squeeze the worst for two consecutive years since the 1930s.

All of which has challenged the view of Britain's top economic official, George Osborne, that during a time of high deficits and economic weakness, the best approach is to aggressively attack the deficit first, through rapid-fire cuts aimed at the heart of Britain's welfare state.

Doing so, says Mr. Osborne, the chancellor of the Exchequer, secures the trust of the financial markets, and thereby ensures the low interest rates necessary for long-term economic growth.

That approach, and the question of whether it risks stifling an economic recovery that might itself help narrow the budget gap, lies at the root of the deficit debate in the United States. On one side is the go-slow strategy favored by [President Obama](#). On the other is the more radical path championed by the Republicans. The two camps are no doubt closely watching Britain's experiment.

On paper, at least, both countries face broadly similar deficit challenges. Britain aims to close a fiscal gap of about 10 percent of gross domestic product. The comparable figure in the United States is 9.5 percent.

In Washington, the Republican proposal recently sketched out by Representative [Paul D. Ryan](#) of Wisconsin calls for broad and significant cuts in social spending, including [Medicare](#) and [Medicaid](#), and wide-ranging tax cuts.

On Wednesday, President Obama called for a more balanced approach, one that he said would combine some tax increases for the wealthy with selective spending cuts that he said would not break the "basic social contract" of programs like Medicare and Medicaid.

While severe in its approach to spending cuts, the British plan lacks the stark sweep of the Republican proposal. Britons will certainly feel pain at the local government level as money dries up for care of the elderly, youth programs and trash collection. But icons like the National Health Service have largely been spared.

Other notable differences suggest that even Europe's most conservative party is markedly to the left of the mainstream Republican position in the United States, and in some ways is more liberal than the position Mr. Obama has taken.

To strike a political balance, the coalition government led by Prime Minister [David Cameron](#) of the Conservative Party, Mr. Osborne — himself a Conservative — has retained a 50 percent income tax rate on the wealthiest individuals. That is among the highest in Europe, and it imposes more of a burden on the rich than anything Mr. Obama or anyone else in Washington would find politically feasible.

But in Britain, the big worry now is not tax rates. Instead, the fear is that Mr. Osborne's emphasis on cuts in social spending — which aim to achieve an approximate budget surplus by 2015 and are likely to result in the loss of more than 300,000 government jobs — might tip the economy back into **recession**.

Already the government has had to slash its growth estimate to 1.7 percent, from 2.4 percent, for this year, as consumer incomes are under pressure from high inflation, weak wage growth and stagnant economic activity.

“My view is that we are in serious danger of a double-dip recession,” said Richard Portes, an economist at the London Business School. “This is going to be a cautionary tale.”

Not all economists agree, of course. And this week's slight improvement in the unemployment rate, to 7.8 percent from 7.9 percent, suggests it is still too early to declare a second slump inevitable.

No one would disagree with Mr. Portes that a deficit of 10 percent of G.D.P. is unsustainable in the long run. But, with the opposition Labour Party, he argues that moving so quickly in the face of weak economic growth is not justified.

Mr. Osborne proposes to slash the deficit to 1.5 percent by 2015. By comparison, the stark program Mr. Ryan offers does not project reaching that deficit target until 2021.

Besides the difference in speed, a crucial distinction is how each plan would reach its goal. Mr. Osborne's plan calls for 75 percent of savings to come from spending cuts, and the rest from mostly indirect revenue and tax increases — an increase in the sales tax, for example.

Mr. Ryan, on the other hand, proposes to slash spending by \$5.8 trillion but — in contrast to the British approach — would allow most of the spending reductions to be offset by \$4.2 trillion in tax cuts, rather than applied to closing the deficit gap. In other words, while Mr. Ryan would lean heavily on spending cuts to close the deficit, he also hopes to spur the sort of supply-side economic growth

most often discussed when **Ronald Reagan** was in the White House.

But while the continued lure of Reagan-style tax policy seems to have contributed significantly to the Ryan plan, Mr. Osborne has defied the popular caricature of him as a heartless Tory pushing a Thatcher-esque agenda. He has refused to cut the tax rate for top earners, despite calls to do so from his party's right flank and Britain's powerful financial sector.

Such an approach might still be heresy to many Republicans in the United States. But in Britain, as in the rest of Europe, it has become widely accepted.

"It's hard to cut taxes and lower the deficit — that is why personal tax cuts can't be justified," said Patrick Nolan, chief economist at Reform, a right-of-center research organization based here.

Mr. Osborne has taken other steps to make sure the wealthy pay their share, from taxing banks to the oil companies, which Mr. Osborne's top advisers say is crucial to convincing Britons that sacrifice will be shared. While gritting their teeth at these populist measures, Britain's businesses and banks have largely accepted Mr. Osborne's plan.

Last week, as Portugal became the third country in Europe, after Greece and Ireland, to petition the **European Union** for a financial bailout, Mr. Osborne was vocal in underscoring his central contention as a deficit hawk: that in this new debt-averse era, no country has the luxury of delaying the painful steps needed to balance government books.

Many analysts support that view.

"People can march and break windows all they like, but you can not get away from not cutting the deficit," Douglas McWilliams, the chief economist at the Center for Economic and Business Research and an author of its report on the plight of the British consumer.

His forecast of about 1 percent British economic growth this year is one of the lowest to be found anywhere. Yet he, too, says that to backtrack now from the government's austerity plan would be folly

— and would severely rattle the British bond market, which has been quite forgiving compared with the high interest rates the markets have imposed on Greece, Ireland and Portugal.

Remarkably, yields on the British government's 10-year bonds are slightly above the 3.6 percent or so achieved by Germany, which has Europe's healthiest economy. That is partly because Britain lies outside of the euro zone and can control its own monetary policy. But those relatively low interest rates have helped gird the support Mr. Osborne has so far received from the British business community.

In that sense, comparing the British and American deficit-cutting plans becomes a bit more difficult. In Europe the bond market is the ultimate judge of deficit-reduction plans. In the United States, by contrast, the global demand for **Treasury bills**, and the benefits of the Federal Reserve Board's easy-money "quantitative easing" policy, have kept 10-year bond yields well below those of Britain.

Those low American interest rates, in turn, have reduced the pressure on Washington to take more immediate, painful steps to pare the deficit.

But, as the example of Europe has borne out, at some stage foreign bond investors might tire of financing unsustainable deficits — even Washington's. If and when they do, a government has little choice but to cut.

How deep, and how fast, depends on how long a government waits to begin.



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