

## Business

# Budgets the Tories must choose from

THOUGH Tory leader David Cameron and shadow chancellor George Osborne seem increasingly confused about what to do when in power to tackle the public sector deficit and associated mountain of debt, there is no reason for the rest of us to be in the dark. It is obvious that if they have the chance they will do what previous Tory governments have done.

For that, they need to adopt one of two models. The first is Geoffrey Howe's Budget of 1981, the second the 1993 Budgets (there were two) of Norman Lamont and his successor Ken Clarke. The first was brutal in its cuts and disastrous for the economy at the time. The second was more subtle and laid the foundation for the growth which the Labour Government was lucky enough to inherit.

Until quite recently Osborne and his advisers looked to model themselves on the 1981 Howe – first because there is something deeply ingrained in the Tory psyche which wants to take a sledgehammer to those ranks of social workers, equality advisers and health and safety professionals but also because they believed that it was Howe's cutting public spending and putting up taxes in the teeth of recession which laid the foundation for later growth. To recap – and

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thanks here to PricewaterhouseCoopers' Book of Modern Budgets for the details – in the 12 months before Howe's Budget, unemployment had risen by more than one million, GDP had dropped by 2.5%, manufacturing output plunged by 9% and the public sector deficit, which had been forecast at £8.5 billion, came in at £13.5 billion. Howe froze personal allowances, created a new tax on North Sea Oil, imposed a £400 million windfall tax on banks and sought to offset the massive fiscal squeeze with a 2% cut in interest rates to 12%. Those were the days.

This is what Osborne is thought to have in mind when he talks about tough decisions. What he needs to remember though is that the economy dropped off a cliff after the Budget and it set off a summer of riots in London, Liverpool, Bristol and several other cities. The Tories also fell massively behind in the polls and would have been

thrown out at the next election had not their popularity been transformed by the Falklands War the following year.

Ten years later and after the collapse of the Lawson boom, the public sector deficit ballooned to levels no one had seen before, and the economy once again plunged into recession. That was the background for the April and autumn budgets of 1993. Fiscal policy needed to be tightened but what first Norman Lamont and particularly Ken Clarke did was announce their intention to increase taxes – but not yet. That demonstrated to buyers of government debt that there was a plan to bring things under control but did not further kick the economy when it was already down. So for example mortgage tax relief was cut with effect from two years out; VAT on fuel bills was to be phased in, air passenger duty and insurance premium taxes were introduced with effect from late 1994. Public spending was capped, but there was no overblown rhetoric about cuts – largely because the experience of all governments every time is that they fail miserably in their efforts to do so.

The 1993 Budget was a huge success. The pound had fallen, exports soared, growth resumed and within five years the economy was in its best shape for

years – just in time for the Labour victory in 1997.

Given that Ken Clarke remains one of the most impressive figures in the Shadow Cabinet it is hard to believe that the Tories, if elected, will do other than repeat what they did in 1993. Indeed there is very little need to do otherwise – in spite of all the talk of a new age of austerity – and very little need for tax increases as City economist Roger Bootle demonstrated recently.

He pointed out that one reason projections for government spending look so alarming is that they have a built-in adjustment for inflation. This means that simply capping money expenditure at current levels, would in effect amount to a real money cut of about 2% and if absolutely nothing else were done this alone would save £20 billion a year. Thus over four years spending would be reduced by £80 billion which would eliminate by 2015 the structural deficit everyone is so worried about.

So the real debate is not how much the government should spend but what it should spend the money on. It needs to quit all areas where the private sector could do better and focus on those areas where it is the best provider. The Tories and Lib-Dems need to tell us their ideas about what those areas are.

## A City funding success story

HAVING had a rant earlier this week at the general reluctance of the City to fund small UK businesses, it is only fair to acknowledge when a firm has, and it has worked.

Minivator is a company that makes stair and bath lifts and other personal hoists to help the elderly and infirm, which are installed so they can continue to live in their homes.

In 2004, private-equity firm Gresham put £4 million into the company, giving it the capital to invest heavily in research and product development. In the following years, the number of employees rose by 75% and turnover doubled, until earlier this week the company was sold to a trade buyer.

Gresham made a profit of 3.4 times on its investment over the six years – which is a much better return than you would have got from investing in the FTSE index.

So it can be done, and it is being done. The thing is that we just need more of it.

Anthony Hilton's archive:  
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# Eurozone mess shows UK was right not to join

We could have faced same woes as Greece, says a leading Eurosceptic. Tomorrow a pro-European hits back

THE government tells us that we are out of recession – but only by one tenth of one percent growth. Any smaller and it would have vanished all together. After the brutal negatives of the last year, our economy could not get any more fragile. Or could it?

What if we had been a member of the Eurozone? Had we been in the euro these last few years, our economic state would not be a disaster, it would be a catastrophe. Our already damaged economy would have been crippled by a fixed exchange rate set by the so-called "successes" of the financial sector.

Instead, when our financial sector collapsed, the pound fell.

Outside the euro, sterling has been trading at a competitive level in global currency markets. British exports remained at attractive prices while euro-denominated goods raced to all-time highs against the pound and the dollar in 2009. This is the main reason we had a record manufacturing upturn in January, and without the beginnings of

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that upturn we would have still been in recession. In Greece, Ireland and Spain, all in the eurozone, manufacturing is struggling. The biggest of these, Spain, is unlikely to see an economic recovery this year.

So managing our own currency is critical to our ability to compete. Giving up our currency would also have meant giving up to the European Central Bank our ability to control interest rates. The ECB has kept interest rates significantly higher than rates in the UK.

The Bank of England has kept our rates low and pumped money into the



**Euro currency woe:** Greek construction workers march against austerity measures

economy, allowing companies to absorb the shock of recession and start to recover. None of this would have been possible had we joined the euro.

Those countries in the eurozone whose governments have, like Gordon Brown, behaved in a profligate manner, are now paying a fearsome price.

As well as the higher ECB base rate, they are being punished by the bond traders who are charging them for the riskiness of their national balance sheets. Greece, for example, is facing some of the highest interest rates for a decade, and is finding it hard to compete for funds with other eurozone countries.

What is worse, before the current crisis, membership of the eurozone lulled Greece into a false sense of security. Leading up to the budget

problems in Greece, their government bond yields barely indicated the growing risk of Greek debt. The market was distorted, failing to convey information about the state of finances in Greece.

Even worse, the rest of the eurozone has been subsidising the bloated spending programmes of the Greek government, offering them no incentive to restrain extravagant and sumptuous behaviour.

This may well be why the Greeks were the first European nation to have their credit rating downgraded. Had we been a member of the euro, we would have suffered a similar fate. To add insult to injury, like Greece, had we been in a similar fix, we would have been denied balance-of-payments aid.

We have our own house to put in

order, and that is not something we should entrust to a system controlled by foreign states who, quite reasonably and properly, have interests other than our own.

The UK currently ranks 126th out of 133 countries analysed for the soundness of their banks, according to the World Economic Forum. Our banks are amongst the most likely in the world to become insolvent and require a government bailout. Our national finances are in a parlous state.

Yet unlike the Eurozone countries of Greece, Ireland, Portugal and Spain, our national credit rating has not been downgraded.

Do we want to find our banks, not to mention the families and businesses they serve, in the same position as these governments, trusting their livelihood to Eurocrats, when the financial markets themselves do not trust them?

About 15 years ago, I was one of a team determined to keep us out of the euro. We were influenced by a hard-headed consideration of all the previous attempts to bind the currencies of disparate economies together. Most had crashed and burned at the first stress on the system.

The euro is facing its first stress-test since its adoption in 1999, with the looming financial problems of Greece, and now Ireland, Portugal and Spain, all testing the euro's ability to absorb shocks during a recession. We have yet to see the conclusion of this continent-wide experiment.

For ourselves, the pound has served our country well over the past ten years, in the good times and in the bad. Sterling is helping pull us out of the recession. This is no time to abandon a steadfast friend.

David Davis is Conservative MP Haltemprice and Howden and former shadow Home Secretary