‘Ending the party’:
A practitioner’s perspective of fiscal squeeze

*At an event held at the British Academy on 9 July 2013, **Rachel Lomax** recalled past examples of fiscal squeeze and compared them with current circumstances – in conversation with Professor Tony Travers.*

Rachel Lomax is an economist with long and varied experience of policy making. She was a Deputy Governor of the Bank of England and a member of the Monetary Policy Committee between 2003 and 2008. Previously she was a top civil servant, who headed three Government departments, Transport, Work and Pensions, and Wales. Her earlier career included spells as Chief of Staff to the President of the World Bank, and as Head of the Economic and Domestic Secretariat at the Cabinet Office. She was Principal Private Secretary to the Chancellor of the Exchequer, Nigel Lawson, in the mid 1980s, and a Treasury economist during the 1970s and early 1980s. She now serves on the boards of a number of financial and non-financial companies, including HSBC and Heathrow Airport.

Tony Travers is Director of LSE London, a research centre at the London School of Economics, and is also a Visiting Professor in the LSE’s Government Department

This is an edited version of the conversation, which ranged from the IMF crisis of 1976 to current times. A video recording of the whole event may be found via www.britac.ac.uk/events/2013/

Professor Tony Travers

What is learned each time there is a crisis and then a boom and then another crisis? Is there any institutional memory? Is there any sense that, next time it happens, one can learn from what happened last time, which may only be 15 or 20 years ago?

Rachel Lomax

I was in the Treasury during the ’70s, ’80s and early ’90s, and there was a fairly stable group of people working on these issues throughout that period. As I remember it, there was a long process of trial and error. It was a case of ‘We tried that, it did not work, let us try something else.’ The road to inflation targeting is a good example. We tried different kinds of monetary targets and they did not work; then we went on to shadowing the Deutsche Mark; then we went into the ERM (exchange rate mechanism) and that did not work; so then we tried inflation targeting. There was quite a learning period – or that is how it seemed to me.

Finding a framework for setting fiscal policy was even more of a struggle. We used to play around with notions of debt sustainability, but they are very elastic, as governments have found recently. We used to argue there was a relationship between the PSBR (public sector borrowing requirement) and interest rates, but it was never easy to quantify. The fiscal rules that Gordon Brown constructed in the late ’90s were consistent with the way thinking inside the Treasury had developed. In that sense there was learning in the area of fiscal policy too.

Post-1997, a period when I have not been in the Treasury, my observation is that there has been a severe loss in the Treasury’s internal memory, principally because the turnover of staff has been so high. There was a large exodus of people during the 1990s, followed by a huge expansion of the Treasury after 1997. I can remember talking to a room full of people in the Treasury in about 2004, and saying, ‘Please put your hand up if you were here before 1997.’ About three people put their hand up at the back of the room. Now, maybe the people who turned up to listen to me talk were the people who weren’t there before. But there really was a lot of turnover in the Treasury, and that inevitably led to a loss of the

Rachel Lomax in conversation at the British Academy on 9 July 2013.

department's collective memory. Nowadays we seem to be much more dependent on think-tanks, academics, and people in the City to think about these issues. Certainly it is less possible to count on a small cohort of life-long Treasury civil servants to design policy.

Tony Travers

That is a pretty remarkable observation. The idea is that the civil service is supposed to be permanent and government is a continuous thing. And yet you are saying that government relies on outsiders in order to allow itself to have a memory.

Rachel Lomax

I think that the notion of a permanent civil service in the old sense, the sense in which it was true in the '60s and '70s, has changed quite profoundly. There has been enormous turnover in permanent secretaries; and people come in to run government departments who have never worked in government; there has been a lot more in and out. The position of the civil servants *vis-à-vis* ministers, and special advisers (who are a completely different breed now), and think-tanks, has changed a great deal. Some of it is healthy and some of it is not healthy.

The Treasury is not the institution it was, and that is scarcely surprising. The world has changed. Basically, in the 1960s or 1970s if you wanted to be a macro economist, and if you were interested in policy, the Treasury was the place to go – where else was there? The pre Big Bang City didn't employ economists – or precious few. Nor I think did the big consulting firms – that came much later. Starting in the late 80s, there has been a massive growth in very well paid opportunities for top flight graduates – the sort of people who might have once regarded a job at the Treasury as the summit of their ambitions. Of course, there are still some very smart people who do start their careers in the Treasury but nowadays they go off somewhere else after a couple of years. This process has been going on since at least the late '80s, and as pay disparities have opened up it has gathered pace. Has it now reached the point where the impact on the Treasury has gone too far? Possibly. That said, back in the '60s and '70s, I felt there were more talented people sitting around the Treasury than strictly necessary. So the correction was in part healthy and an inevitable consequence of the wider development of the economy. But what does rather depress me is the apparent hostility towards the permanent civil service on the part of some politicians. Some of it is natural – inexperienced ministers and their personal advisers have always tended to feel somewhat suspicious of the permanent civil service and maybe threatened by people who know more about the business of government than they do. Instead of realising that civil servants want to help them, they cast them as the enemy, and not infrequently appear to despise them for not having gone for better paid jobs at McKinsey or Goldman Sachs or wherever. That is not healthy and it is certainly no way for a Government to get things done.

This event was organised in connection with a British Academy Conference entitled 'When the Party's Over: The Politics of Fiscal Squeeze in Perspective', held on 9-10 July 2013. The conference – convened by Professor Christopher Hood FBA and Professor David Heald, and arranged in association with the Economic and Social Research Council – explored how the politics of fiscal squeeze has played out in different times and places. It looked in depth at nine cases of fiscal squeeze, and considered what conclusions we can draw for current debates about fiscal squeeze from earlier cases in other democracies. The closing discussion was chaired by former Cabinet Secretary, Lord Gus O'Donnell. It is intended that a volume of essays will be published in the *Proceedings of the British Academy* series. Further information on the conference can be found via www.britac.ac.uk/events/2013/

On the evening of 10 July 2013, there was a public event on 'Reacting to Fiscal Squeeze: Some Artistic Responses', which looked at how times of economic crisis have been reflected in cartoons, social history, art and film. A video recording of the event can be found via www.britac.ac.uk/events/2013

'I'm a banker. Give my bill to one of the other tables'

Cartoon by Matt (Matthew Pritchett), Daily Telegraph, *20 January 2009.*
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Tony Travers

Looking at the current squeeze from the outside, do you see things that you might have hoped government would avoid this time? Take an issue like whether public spending and tax policy is set politically – with a view to making life difficult for the opposition. Accusations of that kind are regularly made. Has that ever happened before? Do you think it is happening now?

Rachel Lomax

Before the 1992 election, and certainly before the 1997 election it did look as if the government was laying a bear trap for its opponents. The Conservatives thought they were going to lose the 1992 election; they knew they were going to lose the 1997 election. Gordon Brown walked straight into it by saying, 'I am going to adopt the spending targets that I am left'. The result was he inherited some eye-stretchingly difficult spending plans.

Tony Travers

Do you think there was an element of purpose in that?

Rachel Lomax

Sure. I was a Permanent Secretary at that stage, and I can remember saying to my incoming Secretary of State, 'They would never have stuck to these targets, do not be fooled.' Every Permanent Secretary around Whitehall was telling their Secretary of State that these figures were not for real. But unfortunately, the new government did stick to them, with a few exceptions, and as a result they lost two important years. And then, when the moment to ease spending came, they were trying to run very fast to catch up for lost time, and they pumped up spending too fast. If they were able to rerun history, I expect they would do it differently.

Ed Balls was about at the time, so he knows the dangers. He is smart enough to leave himself a little bit of wiggle room. And the situation is different now. I do not believe that this Government thinks it is doomed to lose the next election. The Conservatives were bone weary by 1996-97: they had not expected to win in 1992, and in 1997 they just knew they were going to lose. George Osborne will hedge his bets; he will not do anything that he will live to regret himself, because he hopes to be back. And Ed Balls has been there and will leave himself a bit more wiggle room. So, at least at the political level, there may be a bit of learning from the past.

Audience member

How often, during periods of intense fiscal squeeze, do quite wild ideas get floated? And how often do those seemingly wacky ideas, if they are actually implemented, sometimes turn out to be a surprising success?

Rachel Lomax

Undoubtedly, there have been wacky ideas and a few of them, when implemented, have been a great success. My memory of apparently wacky ideas that turned out to be a huge success dates from the Thatcher years. However, I do not think they were driven by fiscal imperatives, so much as a desire to improve what we used to call 'the supply side' of the economy.

The extent to which this Government has allowed itself to be defined by fiscal consolidation and nothing else is remarkable and possibly unparalleled. Yes, we have had periods where people have had to bear down on public spending and have tried to reduce the PSBR, but that has usually been in the service of some broader objective like reducing inflation or getting interest rates down because they are at 15 per cent. But the present Government has effectively defined the financial crisis as being primarily about fiscal policy. We have a fiscal problem for sure, but it is the consequence of the financial crisis not its root cause. And the policy that binds the Coalition together is fiscal consolidation. For political as much as economic reasons the Government's strategy is all about austerity. It is not about making the economy work better; it is not about bringing inflation down; it is not about bringing interest rates down. There has been surprisingly little attention paid even to repairing the financial system, as opposed to heading off another financial crisis. So it is a particularly austere form of economic policy, it seems to me.

Typically you bear down on spending by deciding in very broad terms which programmes to squeeze and by how much, and then asking departments to come up with ideas to achieve the required level of cuts. The Treasury will usually throw in ideas of its own, as well. Don't forget this is a negotiation. So, as a spending department, you do not say, 'We could easily do that, I have a couple of sensible ways of doing it.' You think of unattractive options; it is part of the way the argument is conducted. It is the Treasury's job to filter out those proposals that are political poison pills and focus the debate on sensible options. In practice any spending settlement may leave a lot of savings still to be itemised. So it may not be until later, when departments find themselves with shrunken budgets, that they get real and review the hardest options. They start saying things like, 'Why not sell off all our estate?' and have facilities management. That's what DSS did in the mid 1990s – and it turned out to be a very creative idea which has since been copied by many other organisations. That was radical rather than wacky, but the point stands.

So it's true that some of the ideas that come out of applying a sharp squeeze can be perfectly sensible. But not all are. As a general point, in my experience 'good' wacky ideas have usually been about for a while, and they are rarely if ever just about saving money However, the prospect that they might save money sometimes gives Ministers a bit of extra political courage.

Audience member

I worked in the Treasury from the mid 1970s to the mid 1990s. Experience shows that recent downturns are very good for reminding you of lessons you might otherwise have forgotten: how best to spend money to increase employment, how vulnerable your fiscal balance is to cyclical downturns, some of which governments always underestimate by miles. How sophisticated is the system you want to run? Crucially, what is the role of the finance ministry? A finance ministry, every now and then, has to be a paid party pooper, and when it forgets that is its role, disaster strikes.

Where are we on banking reform?

On 27 June 2013, Professor Sir John Vickers FBA delivered the British Academy's 'Anglo-German Foundation Lectures'. Sir John, who in 2010-11 chaired the Independent Commission on Banking, looked at where we now stand, five years on from the start of the global financial crisis, on progress towards banking reform.

This is the third in a series of lectures that commemorates the work of the Anglo-German Foundation for the Study of Modern Industrial Society (which existed 1973-2009). In 2013, the lecture was hosted by the Berlin-Brandenburg Academy of Sciences and Humanities, in Berlin. A video recording of the lecture can be found via www.britac.ac.uk/events/2013/

Rachel Lomax

I agree with that, and when the Treasury thinks it is an economics ministry, that is usually a bad sign. You have to keep your eye on the ball. Being a finance ministry is tough enough.

The great enemy is complacency; I am absolutely certain of that. We got very complacent in the late '80s; we got very complacent in the mid 2000s. No amount of remembering that times used to be worse is a guard against feeling that, 'This time, we have cracked it, we have learned how to do monetary policy, we have learned how to control spending.' Civil servants are as prone to complacency as people in central banks, or politicians, or the general public.

Tony Travers

By common consent, the UK needs growth.

Rachel Lomax

That is precisely the issue we set out to address in the London School of Economics Growth Commission. There are three areas we pulled out, which seem to me to be absolutely key: infrastructure – and I do not mean spending money digging holes for the sake of it, I mean fixing our critical infrastructure in a way that supports the economy, for example by removing bottlenecks; improving education especially for the long tail of underachievers; and sorting out our financial system. Those are the things that are holding us back and they need fixing. But they will take time to work. Personally, I think that fixing the financial system is an absolutely necessary condition of really getting the economy moving again – far more important than almost everything else. We are still recovering from a global financial crisis that seriously damaged our core banking system. The first priority should be to sort that out. It was not Gordon Brown's fiscal profligacy that got us into this mess; it was a major banking crisis. And until you have cleaned up that mess – and I do not mean thought about how you might like to regulate an ideal banking system in the year 2025, I mean fixing the banks that failed – you are not going to get sustainable economic growth.